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FACT SHEET

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Electricity and Natural Gas Rates

The California Public Utilities Commission and Cal Advocates Can Better Ensure That Rate Increases Are Necessary

Background

Our audit focused on electricity and natural gas rate increases of four large utilities—Pacific Gas & Electric (PG&E), San Diego Gas & Electric (SDG&E), Southern California Edison, and Southern California Gas Company—and the oversight conducted by the California Public Utilities Commission (CPUC) and the Public Advocates Office (Cal Advocates). The rates for all four utilities have been rising, and California's electricity rates are among the highest in the nation. State law empowers the CPUC and Cal Advocates to protect customers from potential energy rate abuses. Some of the elements contributing to electricity and natural gas rate increases are outside the control of the CPUC and Cal Advocates; however, both agencies can better protect customers by implementing certain improvements to their oversight.

Key Findings

» Several factors have contributed to increases in electricity and natural gas rates for the four utilities we reviewed:
  - Utilities' operating costs, which they recover through rates, have been increasing. Each utility saw the largest increase in a different category: increased distribution costs for PG&E, increased administrative costs for SCE, and higher property and other non-income taxes for SDG&E.
  - Wildfire mitigation costs and other emergency-related costs, such as insurance, have also been key factors contributing to the increases in the electric utilities' operating and overall expenses.
  - Decreasing electricity sales due to increasing installation of solar power systems has required utilities to raise rates to recover certain fixed costs.
  - Market forces, such as higher demand due to unusually cold temperatures, Russia's invasion of Ukraine, and low national gas storage levels have contributed to the rising natural gas rates.

» The CPUC and Cal Advocates need to strengthen their processes to better protect customers:
  - In nine of the last 10 years, San Diego Gas & Electric's (SDG&E) actual rate of return was higher than its authorized rate of return, raising questions about the accuracy of SDG&E's forecasted costs.
  - The CPUC and Cal Advocates could strengthen their processes for verifying whether the utility has completed the work for which it is seeking cost recovery. If they do not do so, they will increase the risk of allowing the utility to inappropriately recover costs from its customers that it did not, in fact, incur.
  - The CPUC does not clearly communicate the reasons for cost increases it authorizes at the start of each rate cycle or for rate increases that utilities seek mid-cycle.

» Cal Advocates does not have a risk-based approach for reviewing balancing accounts, which utilities use to track variable costs that may be difficult to predict and could have a material impact on rates, to ensure that utilities' requests for rate changes are appropriate.

Key Recommendations

» To promote transparency, the CPUC should institute a process that requires utilities to periodically publish actual rate-of-return calculations using methodology acceptable to the CPUC and Cal Advocates. It should also require utilities to identify the major cost categories in which projected costs exceeded actual costs.

» The CPUC and Cal Advocates should strengthen their processes to verify whether a utility has completed the activities associated with the costs it claims it unexpectedly incurred and is seeking to recover through rate increases, for example, those costs associated with restoring power during a natural disaster.

» The CPUC should also clearly and comprehensively communicate to customers the reasons for cost increases it authorizes at the start of each rate cycle and the reasons for rate increases that utilities seek mid-cycle. By not providing customers with such information, the CPUC neglects opportunities to improve the public's understanding of why rates are increasing.

» To ensure that utilities can support the rate changes they request, Cal Advocates should verify whether "balancing account" balances and the resulting rate changes are accurate and comply with CPUC rules.

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August 29, 2023
2022-115

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As directed by the Joint Legislative Audit Committee, my office conducted an audit of the California Public Utilities Commission (CPUC) and the California Public Advocates Office (Cal Advocates). Our assessment focused on electricity and natural gas rate increases, and we determined that the CPUC and Cal Advocates need to strengthen their monitoring of utilities' costs, and the CPUC needs to provide greater transparency when authorizing rate changes.

We reviewed the rates of four large utilities: Pacific Gas & Electric, San Diego Gas & Electric (SDG&E), Southern California Edison, and Southern California Gas Company. The rates for all four utilities have been rising, and their electricity rates are among the highest in the nation. The operating expenses for the four utilities increased by 5 percent to 37 percent between their two most recently approved general rate cases. However, some of the most significant reasons for the unexpected rate increases in 2022 were because utilities' actual costs were higher than those previously forecasted, and they needed to increase their rates to recover the difference. Wildfire mitigation expenses have also contributed to the rising electricity rates, as has greater solar power adoption by customers, which has reduced electricity sales and consequently resulted in higher rates to recover utilities' fixed costs. Factors contributing to higher natural gas rates since January 2022 included the war in Ukraine, an unusually cold winter in California, and natural gas pipeline disruptions; however, these rates have come down in recent months.

Moreover, the CPUC and Cal Advocates lack processes to ensure that utilities' projected costs are not overstated. For nine out of the last 10 years, SDG&E earned more than the CPUC-authorized rate of return. Reviewing how much the utility earned compared to the authorized rate of return and identifying where the utility was able to gain efficiencies should be a critical first step in ensuring that the utility's projected costs were appropriate. However, the CPUC and Cal Advocates lack a process to identify areas in which the utilities achieved cost savings. Similarly, the agencies could strengthen their processes to ensure that utilities have actually completed the work for which the utilities are seeking reimbursement through rates, such as wildfire mitigation efforts. The CPUC also lacks transparency when authorizing rate changes, because currently available documents do not readily or sufficiently explain the reasons for rate increases. Finally, we found that Cal Advocates reviews an insufficient number of balancing accounts—the mechanism by which utilities track their authorized and actual costs and revenues—to ensure that rate adjustments are supported.

Respectfully submitted,

GRANT PARKS
California State Auditor

Selected Abbreviations Used in This Report

Cal Advocates	Public Advocates Office
CPUC	California Public Utilities Commission
EIA	Energy Information Administration
PG&E	Pacific Gas & Electric
SCE	Southern California Edison
SDG&E	San Diego Gas & Electric
SoCal Gas	Southern California Gas Company

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Summary

Results in Brief

Because energy utilities generally operate as monopolies, state law empowers the California Public Utilities Commission (CPUC) and the Public Advocates Office (Cal Advocates)—an independent consumer advocacy group within the CPUC—to protect customers from potential abuses related to the rates that the utilities charge. The CPUC performs its regulatory role in part by requiring utilities to account for their proposed energy rate increases in formal proceedings, known as the *general rate case*, at the start of each three- or four-year rate cycle. In between these proceedings, utilities may use a separate process to request that the CPUC authorize rate changes. In either circumstance, Cal Advocates' role remains essentially the same: it advocates on behalf of customers for the lowest possible rates consistent with reliable and safe service levels.

Californians currently pay some of the highest utility rates in the country. In March 2023, California had the seventh-highest average electricity rates and the 10th-highest average residential natural gas prices of any of the states. Four utilities—Pacific Gas & Electric (PG&E), Southern California Edison (SCE), San Diego Gas & Electric (SDG&E), and Southern California Gas Company (SoCal Gas)—provide electricity or natural gas to a significantly larger number of people in California than the remaining utilities; consequently, they are the focus of this audit. The electricity rates of the three electric utilities whose general rate case proceedings we reviewed—SDG&E, PG&E, and SCE—have increased during the last seven years, with particularly significant jumps in the last two years.[1] Specifically, from January 2022 to January 2023, the electricity rates for each of the three utilities increased between 16 percent and 23 percent. Similarly, the rates of the three natural gas utilities whose general rate case proceedings we reviewed—SDG&E, PG&E, and SoCal Gas—have also increased dramatically in recent years.[2] In fact, from January 2022 to January 2023 alone, the residential natural gas rates, which include commodity costs, for each of the three utilities increased between 27 percent and 162 percent.

Causes for Increasing Electricity Rates

The electric utilities' operating costs, which they recover through rates, have been increasing. For example, between the last two general rate case proceedings, SDG&E's operating costs increased by 5 percent, while PG&E's and SCE's costs increased by 15 and 37 percent, respectively. Each utility saw the largest increase in a different category: increased distribution costs for PG&E, increased administrative costs for SCE, and higher property and other non-income taxes for SDG&E.

1 SoCal Gas provides only natural gas services to customers; we therefore did not include it in our analysis of electricity rates.

2 SCE provides only electricity services to customers; we therefore did not include it in our review of natural gas rates.

Although the electric utilities did not consistently track their wildfire mitigation costs as a separate category, these and other emergency-related costs, such as insurance, have also been key factors contributing to the increases in the electric utilities' operating and overall expenses. In a May 2022 legislative report, the CPUC specifically highlighted the problem posed by wildfire mitigation costs, which ranged from $323 million in 2021 for SDG&E to more than $2.6 billion in the same year for PG&E. According to SDG&E and Cal Advocates, SDG&E invested significantly in wildfire mitigation activities after wildfires in its service area in 2007 and as a result of related litigation. Although SDG&E's wildfire mitigation costs are increasing, they are not increasing as rapidly as those of PG&E and SCE, whose increased investments began later.

Another trend causing electricity rate increases is the reduction in electricity sales revenue that results from an increasing number of utility customers installing solar power systems, thus decreasing the amount of electricity they need to purchase. CPUC data shows that about 15 percent of SDG&E customers and about 7 and 10 percent of SCE and PG&E customers, respectively, have adopted solar power. With less electricity sales to cover the fixed costs of providing electricity, utilities have had to request and obtain the CPUC's approval to require customers to pay higher rates.

Causes for Increasing Natural Gas Rates

Higher transmission costs—the costs of maintaining and operating the high-pressure pipelines and compressor stations that move natural gas to the distribution system that delivers it to customers—slightly contributed to increases in SDG&E's and SoCal Gas's operating expenses for natural gas services. However, rising natural gas commodity prices contributed to 95 percent or more of the increases in the utilities' natural gas rates from January 2022 to January 2023. The market forces at work include the unusual cold temperatures in early 2021 and early 2022 that created increased national demand; Russia's invasion of Ukraine, which disrupted the international natural gas supply beginning in early 2022; and lower than average national gas storage levels resulting from these shifts in the market.

Weaknesses in the CPUC's and Cal Advocates' Oversight

Some of the elements contributing to electricity and natural gas rate increases are outside the control of the CPUC and Cal Advocates; nonetheless, both agencies can better protect customers by implementing certain improvements to their oversight. For example, the CPUC authorizes the return on investment that a utility can earn in a given year, called a *rate of return*. In any given year, a utility's actual rate of return (profit) may be higher or lower than the rate the CPUC authorized, depending in part on how the utility manages its operations and costs. In nine of the last 10 years, SDG&E's actual rate of return was higher than its authorized rate of return—while PG&E and SCE achieved the same result only two or three times—raising questions about the accuracy of SDG&E's forecasted costs. For example, the CPUC had authorized 7.55 percent as the rate of return for SDG&E during 2020, but SDG&E's

actual rate of return was 9.1 percent during that year. Although SoCal Gas reported lower rates of return than authorized for the two most recent years, it also reported higher rates of return in previous years. The other utilities reported actual rates of return that were generally less than the amount the CPUC had authorized for them. Reviewing how much the utility earned compared to the authorized rate of return and identifying where the utility was able to gain efficiencies should be a critical first step in ensuring that the utility's projected costs were appropriate. However, there is no process to identify the areas in which the utilities achieved cost savings. Thus, it is important that the CPUC institute a process to require utilities to periodically publish actual rate-of-return calculations using a methodology acceptable to the CPUC and Cal Advocates, with supporting data, and require utilities to identify the major cost categories where projected costs exceeded actual costs. The CPUC should then make this information available to Cal Advocates for review.

Further, the CPUC and Cal Advocates could strengthen their processes for verifying whether a utility has actually completed the activities associated with the costs that it requests to recover through a *cost recovery application*. Cost recovery applications are a type of midcycle rate adjustment that utilities can request for some unanticipated costs. For example, in response to a natural disaster, an electric utility might incur additional costs related to restoring power. The law allows the utility to pass this unexpected cost onto customers through rate increases. However, if neither the CPUC nor Cal Advocates strengthens its efforts to verify whether the utility has completed the work in question, such as by performing site visits or by obtaining photographic evidence on a sample basis, they risk allowing the utility to inappropriately recover costs from its customers that it did not, in fact, incur. Nonetheless, neither the CPUC nor Cal Advocates could demonstrate that they have a process in place to consistently verify such costs.

The CPUC also lacks an effective process for ensuring that utility customers are fully informed of the reasons their utility is raising their rates. The CPUC neither clearly and comprehensively communicates the reasons for the cost increases it authorizes at the start of each cycle, nor has it established a mechanism to clearly communicate the reasons for rate increases that utilities seek midcycle. By not providing customers with that information, the CPUC neglects opportunities to improve the public's understanding of why rates are increasing.

The reasonableness of a utility's costs—and ultimately, the reasonableness of the revenue it earns—can be partly evaluated by monitoring a type of account called a *balancing account*. Utilities use balancing accounts to track variable costs—such as the cost of procuring electricity or the cost of wildfire mitigation—that may be difficult to predict and may require midcycle rate adjustments. The CPUC and Cal Advocates review a selection of balancing accounts to ensure that utilities have complied with the terms that the CPUC identified when authorizing the costs or revenues being tracked. This allows them to confirm that a utility's request to adjust rates based on balances in its balancing accounts is appropriate. As of December 2022, the four major energy utilities maintained a total of more than 300 balancing accounts, tracking more than $16.8 billion in cumulative balances—the difference in actual and authorized costs and revenue collection. Nonetheless, during fiscal years 2019–20 through 2021–22, Cal Advocates annually reviewed between

only 35 and 42 electricity balancing accounts for the three major electric utilities, or about 6 percent to 33 percent of each utility's total number of accounts. Moreover, in the same three fiscal years, it reviewed a total of only three balancing accounts for the three largest gas utilities. Cal Advocates explained that it focuses on evaluating new costs affecting future rate increases rather than reviewing the largest balancing accounts pertaining to spending that the CPUC has already authorized. As of December 2021, the four major utilities were collectively tracking roughly $11 billion in undercollected costs in balancing accounts, which may result in higher future electricity rates for customers. However, during fiscal year 2021–22, Cal Advocates reviewed just 18 percent, or $2.8 billion, of the total balances across all accounts that year. In our view, the CPUC and Cal Advocates must coordinate their respective reviews of balancing accounts to maximize reviews of the highest-risk, highest-impact accounts. Given the impact that balancing accounts can have on customers' rates, we are concerned that Cal Advocates does not regularly review those balancing accounts that could have a material impact on rates, to ensure their accuracy.

Finally, Cal Advocates also lacks documented policies that would provide staff with formal criteria for reviewing and filing protests when utilities file their applications to set their rates for the next three- or four-year cycle. Cal Advocates relies largely on institutional knowledge rather than documented policies for determining which parts of those applications to protest and how to conduct those protests. Similarly, it could better demonstrate that it adequately reviews utilities' requests to adjust their rates midcycle. We were concerned that Cal Advocates could not provide a memo or other documentation explaining its rationale for choosing not to protest five of the 12 such requests that we reviewed.

Recommendations

We made the following recommendations as a result of our audit. Descriptions of the findings and conclusions that led to these recommendations can be found in the chapters of this report.

CPUC

To promote transparency, the CPUC should by February 2024 institute a process that requires utilities to periodically publish actual rate-of-return calculations, using a methodology acceptable to the CPUC and to Cal Advocates. Further, when the actual rate of return significantly exceeds the authorized rate of return, the CPUC should require that the utilities identify the major costs categories where projected costs exceeded actual costs and provide supporting documents. The CPUC's Energy Division should then publish this information so that it is available to Cal Advocates and to other interested parties, and it should objectively analyze the information for the CPUC.

To ensure the appropriateness of the activities that utilities include in their cost recovery applications and to reduce the risk of utilities' attempting recovery of costs for work they did not complete, the CPUC should by the beginning of February 2024 develop a process to do the following:

- Ensure that it reviews available reports and work completed by other divisions within the CPUC and by other state agencies to determine whether further verification of a utility's work is necessary.

- Include an audit procedure that requires, on a sample basis, verification that work was completed as claimed in the utility's cost recovery application. Such verification could involve, for example, site visits, photographic evidence of work completed, or satellite imagery.

To ensure that customers can readily identify the factors that contribute to energy rate increases when rates change, the CPUC should by the beginning of February 2024 do the following:

- Provide to the public a summary of energy rate increases. Although the CPUC should determine the exact approach for communicating these increases, this approach should—at a minimum—identify the previous rate, the new rate, and the expected impact on the average customer's bill, and it should explain the CPUC-approved cost components that are driving the rate increase.

- Post all summaries on its webpage in a timely fashion. The CPUC should also require utilities to reference these summaries on their websites within a reasonable time frame.

Cal Advocates

To ensure that the utilities' projected costs are not overstated, Cal Advocates should first obtain information that the CPUC requires utilities to provide, including their actual rate-of-return calculations and the major cost categories in which utilities achieved significant cost savings. Cal Advocates should then use this information in subsequent rate case proceedings to assess the risk that projections in these cost categories may be overstated, and it should scrutinize the projections accordingly.

To ensure the appropriateness of the activities that utilities include in their cost recovery applications and to reduce the risk of utilities' attempting recovery of costs for work they did not complete, Cal Advocates should develop a process by the beginning of February 2024 to gain additional assurance that utilities actually performed the work claimed. This process should include the following steps:

- Evaluate available reports and the work completed by other CPUC divisions and by other agencies to determine whether further verification of a utility's work is necessary.

- Obtain additional information from utilities to verify completion of the work if it determines that further verification is necessary. For example, Cal Advocates could require utilities to provide photographs of work completed for a selection of costs.

- Leverage the audit work that the CPUC performs to avoid duplication of effort.

To ensure that utilities can support the rate changes they request, Cal Advocates should do the following:

- Verify whether balancing account balances and the resulting rate changes are accurate and comply with CPUC rules. Specifically, Cal Advocates should by February 2024 develop a review plan that outlines a risk-based approach for selecting a specific number of electricity and natural gas balancing accounts to review. This plan should specify the criteria that Cal Advocates will use to select the balancing accounts that will have the most impact on rates. If Cal Advocates determines through a staffing analysis that it needs additional staff to perform all the reviews it plans, it should request additional staff through its annual budget process.

- Consult with the CPUC when developing its review plan to ensure that it is not reviewing the same balancing accounts that the CPUC is reviewing and that it is most effectively using its resources to identify and review higher-risk accounts.

To ensure that it consistently and appropriately executes its protests of general rate case applications and advice letters, Cal Advocates should develop written policies and procedures by February 2024 that provide staff with direction on the following:

- The steps staff must take when reviewing and filing protests on general rate case applications.

- The steps staff must take when documenting their analyses of incoming advice letters. Each analysis should include the rationale for protesting or not protesting a letter.

Agency Comments

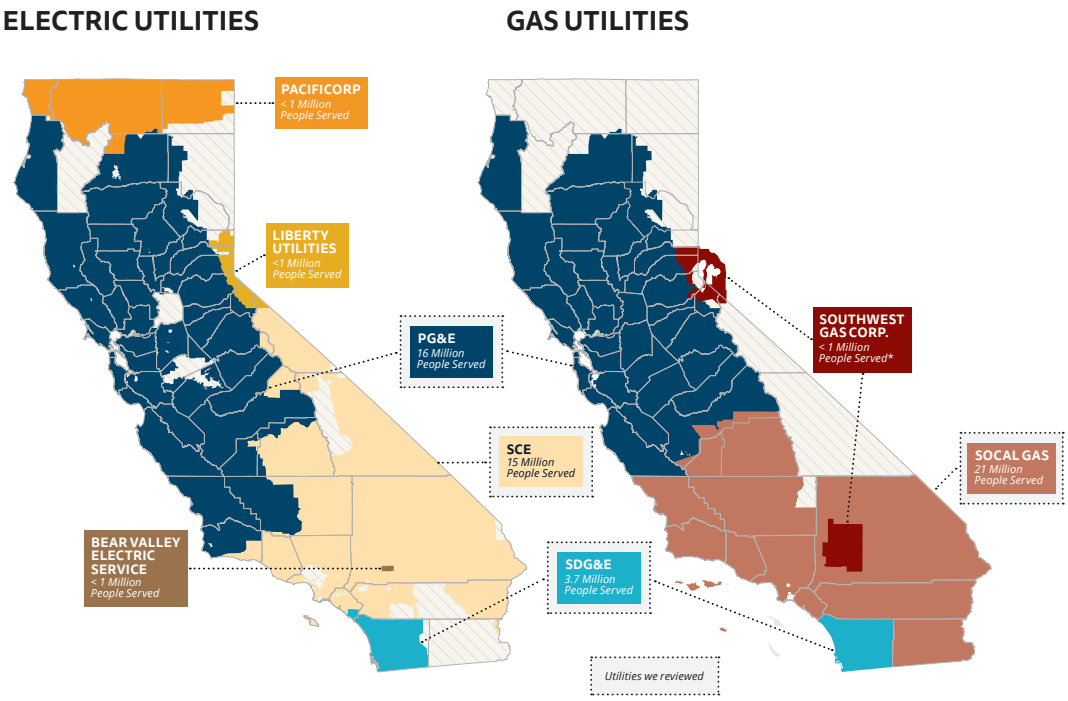
The CPUC agreed to establish a corrective action plan and timeline for implementing most of our recommendations. As indicated in its response, the CPUC had concerns about fully implementing some of our recommendations. However, it specified actions that it would take to at least partially implement the recommendations for which it had concerns. Although Cal Advocates did not clearly state whether it agreed with all of our recommendations, it indicated that it will take appropriate actions to implement them.

Introduction

Background

Californians pay among the highest utility rates in the country. In March 2023, California had the seventh-highest average electricity rates and the 10th-highest average residential natural gas prices of any of the states. The average electricity rate for each of the three largest utilities in California increased by 75 percent from January 2016 through January 2023. As Figure 1 shows, six investor-owned electric utilities and four investor-owned natural gas utilities serve most of California. Three of the investor-owned utilities—Pacific Gas & Electric (PG&E), Southern California Edison (SCE), and San Diego Gas and Electric (SDG&E)—provide electricity to a significantly larger number of people than do the remaining utilities. PG&E and SDG&E also provide natural gas service to their customers; Southern California Gas Company (SoCal Gas)—which is affiliated with SDG&E (both are subsidiaries of Sempra Energy)—provides natural gas service primarily in SCE's service area.

Figure 1
Investor-Owned Electric and Natural Gas Utilities Served Most of the State in 2022



Source: California Energy Commission, utility websites, and the US Census Bureau website.

Note: The unmarked areas of the map are served by other types of electric utilities, such as publicly owned utilities and rural electric cooperatives.

* The total number of people Southwest Gas Corporation served is an estimate based on the more than 200,000 customer accounts it served as of December 31, 2022.

Customers and the media have recently raised concerns about SDG&E's high electricity and gas rates in particular. SDG&E has the highest electricity rate of the large investor-owned utilities in California and, as of March 2023, more than 25 percent of SDG&E customers were more than 30 days behind on paying their utility bills. Our audit focuses on utility rates for SDG&E, SoCal Gas, PG&E, and SCE.

The CPUC Establishes Utility Rates Every Four Years Through the General Rate Case Proceeding for Utilities It Regulates

Because of the high infrastructure costs related to producing and distributing electricity and natural gas, competition among multiple companies each making these types of investments in the same region can be inefficient and costly for customers. Thus, utility companies that provide electricity and natural gas to customers have historically operated as monopolies. To protect customers against abuse of this monopoly power, government agencies regulate the utilities. In California, the California Public Utilities Commission (CPUC) is responsible for regulating investor-owned utilities. The CPUC has five members (commissioners) who are appointed by the Governor and approved by the Senate to serve six-year terms.

The CPUC authorizes the rates that investor-owned utilities may charge their customers. In so doing, the CPUC considers a utility's costs and its profits. To provide safe and reliable service, utilities must be able to cover their operating expenses—their costs. As for profits, the U.S. Supreme Court has established that utilities must be able to earn a reasonable return on investment—a return equal to other investments that have corresponding risks—so that the utilities can attract investors. Utilities obtain the revenue they need to provide for both their operating costs and their profits—a reasonable rate of return—through the rates they charge their customers. According to state law, utilities cannot change their rates without demonstrating to the CPUC that their proposed rates are just and reasonable.

The CPUC Employs Different Mechanisms to Authorize and Adjust Rates

- General rate case proceeding: The commissioners formally authorize a utility to charge rates for the next four years based on the amount of revenue the utility expects to need to cover costs and its approved return on investment.
- Cost recovery application: When a utility has a cost that has not already been authorized through the general rate case proceeding, it may formally apply for authorization to raise revenue to cover the cost. At the end of the proceeding, the CPUC may authorize the utility to adjust its rates, and the utility files an advice letter with the CPUC to implement the changes.
- Advice letter: A utility submits an informal written request to the CPUC for approval to change services or existing rates. For example, when a utility's actual cost differs from those authorized in a CPUC general rate case decision, the utility submits an advice letter to the CPUC to reflect the costs. In other instances, an advice letter may directly implement the terms of a decision, such as for cost recovery.

Source: State law, CPUC rules, CPUC reports to the Legislature, CPUC decisions, and the CPUC's website.

As the text box explains, the CPUC employs different mechanisms to authorize and adjust the rates that a utility may charge its customers. Most significantly, every four years, the commissioners authorize the rates that a utility may charge; they determine the rates through a process known as the *general rate case proceeding*, portions of which are open to the public.[3] As part of this proceeding, the utility files an application with the CPUC, outlining the revenue it forecasts that it will require to recover the utility's anticipated operating expenses plus a return on its investment; this is known as the *revenue requirement*. In that application, an electric utility reports its cost per kilowatt-hour for consideration during the proceedings.

[3] Before 2021 general rate case proceedings set rates for three years. In 2020 the CPUC issued new rules to change general rate case proceedings from three-year to four-year cycles, beginning in 2021.

As Figure 2 shows, the CPUC assigns a commissioner and an administrative law judge (administrative judge) to oversee each proceeding. The administrative judge may administer oaths, examine witnesses, issue subpoenas, and receive evidence during the proceeding. The administrative judge then develops a draft decision, in cooperation with the assigned commissioner, for the commissioners to review. The commissioners may adopt, modify, or set aside the administrative judge's proposed decision and must issue the final decision on the utility's application.

Figure 2
Several Entities Play Key Roles in the Ratesetting Process

Commissioners
Gubernatorial appointees who issue decisions, such as approving a general rate case, and adopt resolutions.

Administrative Law Judge (administrative judge)
Presides over cases, such as a general rate case, and drafts proposed decisions for action by the commissioners.

CPUC Energy Division
Develops and administers energy policy and programs and serves in a technical advisory role to the commissioners and the administrative judges.

Cal Advocates
Represents and advocates on behalf of energy customers to obtain the lowest possible rate consistent with reliable and safe service levels, such as by providing recommendations to the commissioners for a utility's proposed rate change.

Other Advocates
Advocate for consumer protection and industry interests. Includes industry representatives such as the Southern California Generation Coalition, and community-based organizations including the Consumer Federation of California and The Utility Reform Network.

Energy Utility
Submits an application for authorization to charge rates to customers reflecting projected or actual costs to initiate the general rate case and other proceedings.

Source: State law, and the CPUC's and Cal Advocates' documents related to ratesetting proceedings.

The CPUC's Energy Division provides technical advisory support and analyses to the commissioners and administrative judges. The Energy Division stated that it has a legal obligation to maintain neutrality and not to advocate on behalf of ratepayers or utilities since those roles are fulfilled by parties to the CPUC's litigated proceeding. The Public Advocates Office (Cal Advocates) participates throughout the proceeding as an advocate against excessive rate increases. Cal Advocates is an independent entity within the CPUC that is responsible for advocating on behalf of customers for the lowest possible rates consistent with reliable and safe service levels. Cal Advocates participates in general rate case proceedings before the administrative judge and the commissioners. Other third parties, such as consumer advocacy groups, environmental groups, and professional organizations, can also participate in the proceeding. These parties may challenge a utility's application, enter evidence, and offer comments.

Because the general rate case proceeding is an involved process, the CPUC has provided a general timeline of the process to ensure its timely completion. The timeline divides the proceeding into two phases, each of which can take more than 18 months. As Figure 3 shows, a utility's filing of its application marks the beginning of Phase 1, which determines the revenue requirement. This phase consists of multiple procedural steps involving all interested parties. The commissioners' issuance of a final decision on the revenue requirement completes Phase 1.

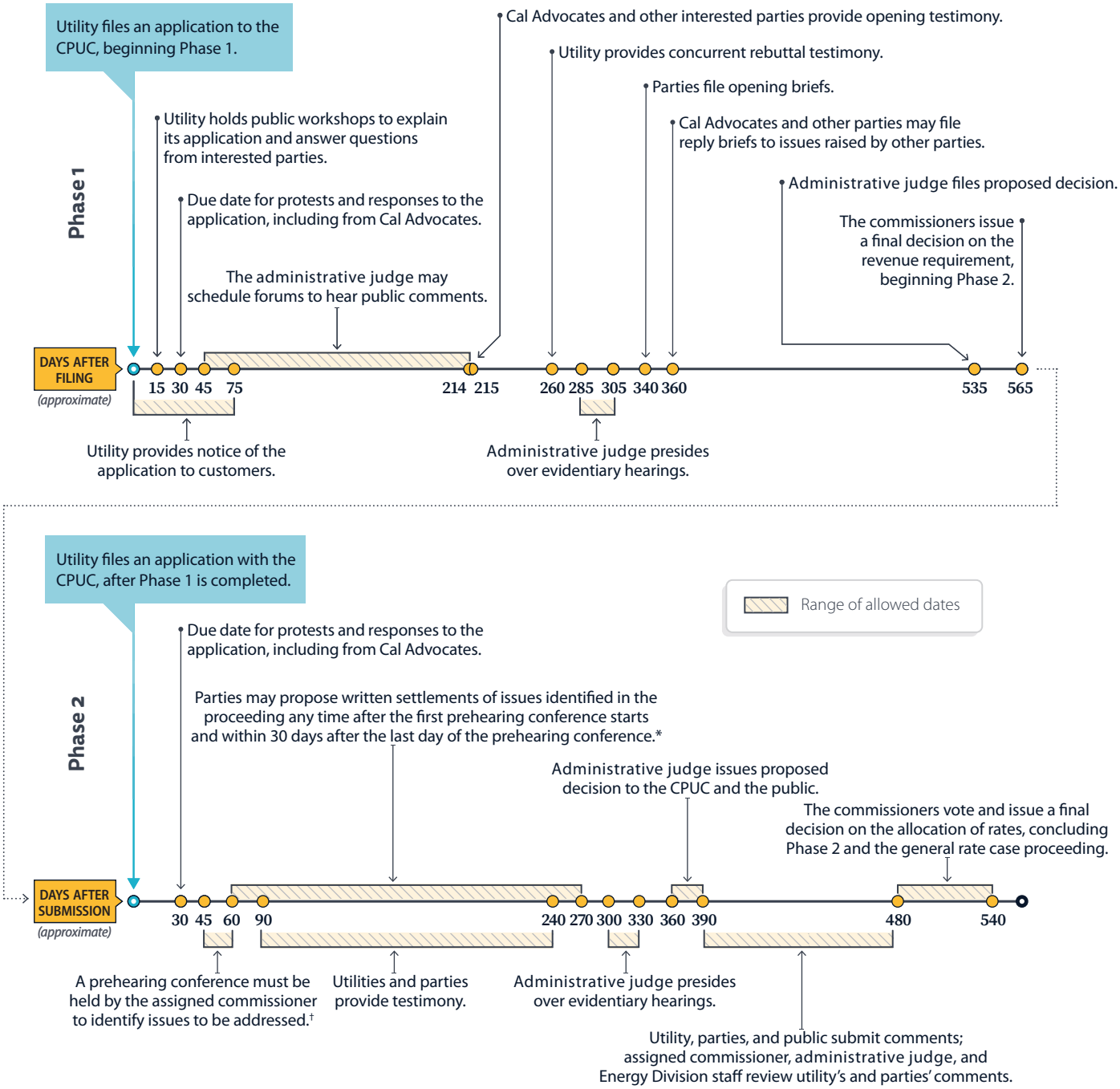
In Phase 2, the utility, Cal Advocates, and other outside entities litigate or enter into a settlement agreement on the actual rates that different classes of customers—such as residential, industrial, or commercial customers—will need to pay to raise the revenue that the commissioners authorized at the end of Phase 1. The commissioners then vote on the utility rates before issuing their public decision, which completes Phase 2.

The CPUC allows utilities to earn a reasonable rate of return to attract investors. The CPUC determines that rate of return through a proceeding—called a *cost of capital proceeding*—that is separate from the general rate case proceeding. Just as they represent customers during the general rate case proceeding, Cal Advocates and interested third parties represent customers during the cost of capital proceeding. An administrative judge presides and develops a proposed decision, which the commissioners may modify before adopting. According to CPUC data, the historically authorized rate of return—which varies by utility—has ranged from 7.3 percent to 8.8 percent annually. The CPUC publishes a utility's authorized rate of return and incorporates it into the general rate case proceeding when determining the revenue requirement during Phase 1.

The CPUC Reviews Utilities' Applications Requesting to Recover Unexpected Costs

Although utilities forecast their future costs during the general rate case proceeding, the utilities may later incur costs that they did not anticipate. For example, a utility cannot always estimate the cost of restoring service after a catastrophic event, such as a wildfire, or the costs associated with new legislation enacted after its general rate case proceeding. Although the CPUC did not authorize these costs, they may be necessary expenditures to enable the utility to ensure safe and reliable service.

Figure 3
CPUC's General Rate Case Proceeding for Large Investor-Owned Electric Utilities (Phase 1 and Phase 2)


Phase 1
Utility files an application to the CPUC, beginning Phase 1.
Utility holds public workshops to explain its application and answer questions from interested parties.
Due date for protests and responses to the application, including from Cal Advocates.
The administrative judge may schedule forums to hear public comments.
Cal Advocates and other interested parties provide opening testimony.
Utility provides concurrent rebuttal testimony.
Parties file opening briefs.
Cal Advocates and other parties may file reply briefs to issues raised by other parties.
Administrative judge files proposed decision.
The commissioners issue a final decision on the revenue requirement, beginning Phase 2.
DAYS AFTER FILING
(approximate)
15 30 45 75
214 215
260 285 305 340 360
535 565
Utility provides notice of the application to customers.
Administrative judge presides over evidentiary hearings.
Phase 2
Utility files an application with the CPUC, after Phase 1 is completed.
Range of allowed dates
Due date for protests and responses to the application, including from Cal Advocates.
Parties may propose written settlements of issues identified in the proceeding any time after the first prehearing conference starts and within 30 days after the last day of the prehearing conference.*
Administrative judge issues proposed decision to the CPUC and the public.
The commissioners vote and issue a final decision on the allocation of rates, concluding Phase 2 and the general rate case proceeding.
DAYS AFTER SUBMISSION
(approximate)
30 45 60 90
240 270 300 330 360 390
480 540
A prehearing conference must be held by the assigned commissioner to identify issues to be addressed.†
Utilities and parties provide testimony.
Administrative judge presides over evidentiary hearings.
Utility, parties, and public submit comments; assigned commissioner, administrative judge, and Energy Division staff review utility's and parties' comments.

Source: The CPUC's website, rules, and manuals, and interviews with CPUC staff.

* Parties may file comments contesting the settlement within thirty days of the date that the motion for adoption of a settlement was served. An administrative law judge may file a proposed decision based on the settlement. If parties do not reach a settlement, Phase 2 can continue for 18 months.

† The assigned commissioner or administrative judge is required by law to prepare a scoping memo that describes the issues to be considered and applicable timetable. However, in most instances, the assigned commissioner or administrative judge may modify this schedule as necessary to promote the efficient management and fair resolution of this proceeding.

Utilities track these unauthorized costs in an account called a *memorandum account* and retain records for further review by the CPUC at a later date. Cal Advocates also reviews a selection of these accounts as part of an annual proceeding to review the costs that utilities incur to procure electricity.

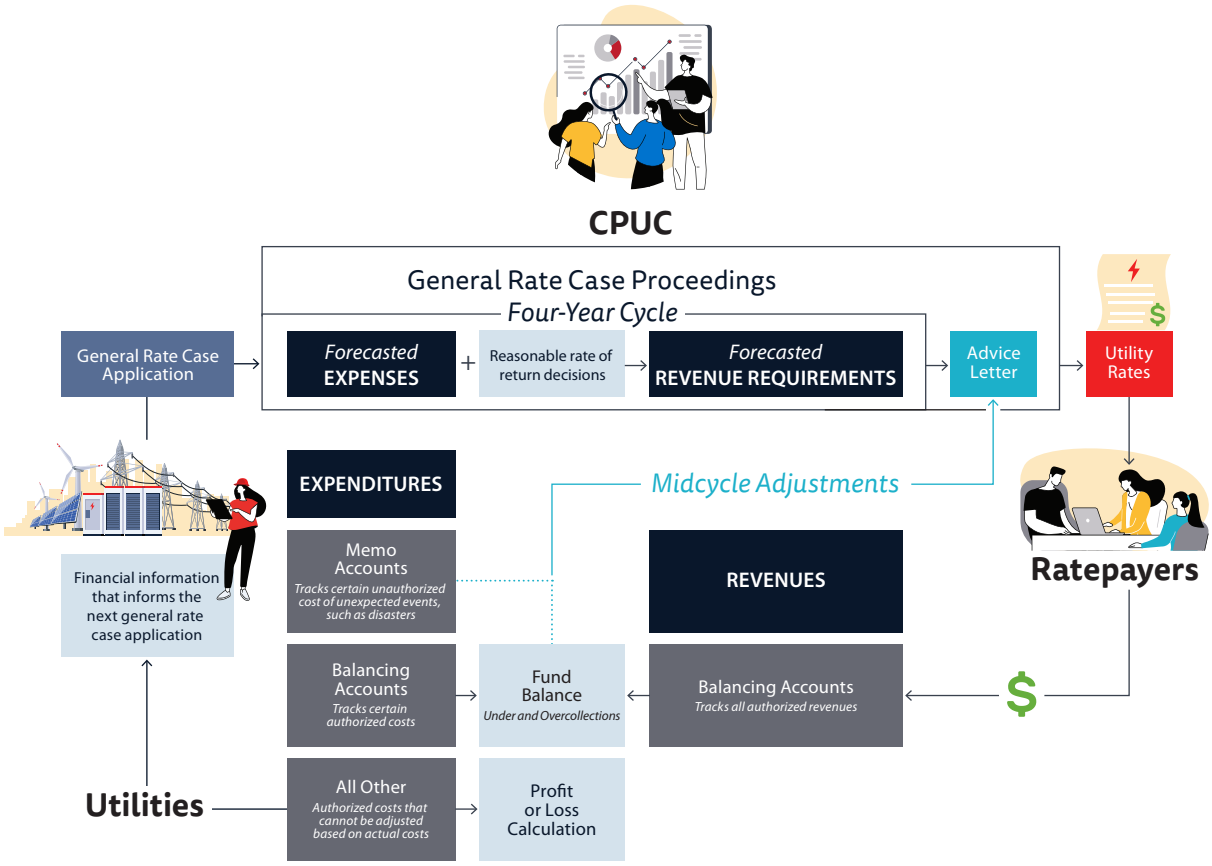
To recover unanticipated costs, a utility may file a cost recovery application with the CPUC. In such an application, the utility must demonstrate that the costs are justified by providing testimonies, supporting documentation, or other means. Just as occurs during general rate case proceedings, an administrative judge presides over the cost recovery proceeding, and interested parties—including Cal Advocates—may protest any part of the utility's request. After hearing all arguments, the administrative judge approves or denies recovery of all or some of the costs by issuing a draft decision. After reviewing this decision, the commissioners may adopt it, modify it, or set it aside. If the commissioners find that the costs are reasonable, the commissioners may authorize the utilities to adjust rates to recover the costs. Such adjustments typically occur through an advice letter, which we describe below.

The CPUC Requires Utilities to File Advice Letters to Adjust Rates Between General Rate Case Proceedings

Utilities submit advice letters—written requests related to natural gas service, electric service, or both—to the CPUC to request approval for services or to change existing rates. An advice letter may implement decisions from any proceeding. For example, when the commissioners authorize costs that a utility requested through an application, such as a general rate case application, a cost recovery application, or a similar application, the utility must file an advice letter to adjust rates to recover those costs.

In addition, an advice letter may address certain differences between a utility's actual costs and the projected costs that the CPUC already authorized. To ensure that the utility is able to recoup or refund the difference by adjusting its rates, the CPUC authorizes the utility to use balancing accounts to track certain actual costs and the revenue it collected from rates. When a balancing account reaches a positive or a negative balance of a certain amount or when a date that the CPUC has specified for that account occurs, the utility needs to request a modification to its rates—increasing rates if it undercollected revenue or decreasing them if it overcollected revenue. For example, the CPUC may authorize a utility to track the actual cost of its employee pension contributions. If the actual contribution cost exceeds the amount that the utility projected it needed to charge customers, the utility can file an advice letter in accordance with the CPUC's instructions to recover the additional costs from customers by increasing rates. Figure 4 illustrates how rate adjustments stemming from balancing and memorandum accounts relate to general rate case proceedings.

Figure 4
The CPUC Has Established a Four-Year Ratesetting Cycle



Source: Documentation from and interviews with the CPUC.

Because utilities use advice letters to implement many types of CPUC actions, the utilities file them regularly. The State's largest investor-owned utilities filed about 3,400 electricity- and gas-related advice letters—between 600 and 1,300 per year—during fiscal years 2019–20 through 2021–22. Most of these advice letters did not directly change rates; in fact, the letters sometimes only announced direct compliance with a decision. A utility providing both electricity and natural gas service might file as few as 14 advice letters in a calendar year that change rates, and those letters are often in response to very specific directions from the CPUC to alter rates based on certain tracked revenue and costs or to alter rates based on natural gas prices.

Advice Letter Types and Approval Levels

CPUC requirements allow Energy Division staff to approve certain advice letters, such as when the CPUC has already authorized a rate change within a specific price range and the proposal falls in that range, but they require the commissioners to approve others:

- Tier 1 advice letters include proposals that the utilities submit to comply directly with a previous CPUC decision or statute. They may take effect upon submission while review by Energy Division staff is pending. Making up about half of the advice letters the CPUC receives, these less controversial requests include the type of advice letter that a utility files after the CPUC approves a cost recovery application.
- Tier 2 advice letters, which include requests to change a rate within a range allowed by the commission, require Energy Division staff approval before they go into effect.
- Tier 3 advice letters are those that do not fall into the other categories, including requests that do not directly follow the wording of a previous law or decision, such as a utility's request to provide a new product or service. They are effective only after the commissioners approve the advice letter.

Source: CPUC orders, cost recovery decisions, online advice letter information, and interviews with CPUC staff.

According to the CPUC, the advice letter process allows it to quickly review utility proposals that are not expected to be controversial and do not raise important policy questions. Depending on the subject matter and complexity of an advice letter, the CPUC's staff or commissioners may approve or reject it. Specifically, as the text box shows, CPUC rules authorize its Energy Division staff to approve energy-related advice letters in certain situations, such as when a state law or the CPUC has already authorized the proposed action. In fact, many of the less controversial advice letters may take effect upon submission to the CPUC while a final determination is pending.

The advice letter process includes a 20-day period during which any person or organization may file a written protest with the CPUC and the requesting utility under specific circumstances. CPUC rules describe several valid grounds for a protest, including when the protesting party believes that the advice letter's contents are inaccurate, unreasonable, or inconsistent with previous CPUC decisions. As part of its statutory goal to advocate for the lowest possible utility rates consistent with reliable and safe services, Cal Advocates reviews all advice letters to determine whether a protest is warranted. When determining whether to protest an advice letter for a balancing account, Cal Advocates assesses whether the advice letter is consistent with the purpose of the associated balancing account.[4] According to Cal Advocates, it does not protest the majority of advice letters because they are generally consistent with CPUC decisions. Cal Advocates also noted that some advice letters are merely informational and that no protest is necessary in such cases.

The CPUC's Ratesetting Processes for Electric Utilities and Natural Gas Utilities Differ Slightly

The CPUC's processes for determining rates are substantially similar for electric utilities and natural gas utilities; however, the processes vary in the timing of rate changes. Both types of utilities submit a general rate case application that outlines the amount of revenue they anticipate they will need to generate through their rates to pay their operating costs and earn a reasonable rate of return for investors. The

[4] Cal Advocates also has a process to systematically review some balancing accounts, a process we describe in Chapter 2 of the report.

utilities that provide both electricity and natural gas services—SDG&E and PG&E—submit a combined application to change both rates under one general rate case. SDG&E and SoCal Gas, because they are subsidiaries of the same parent company, typically request to consolidate the proceedings for their applications.

However, the CPUC's process for adjusting natural gas rates is slightly different from its process for adjusting electricity rates. Neither gas nor electric utilities include the cost of procuring energy in their general rate case proceeding. Gas utilities in California do not produce their own natural gas; instead, they procure natural gas through the commodity market. To address fluctuations in that market, the gas utilities file a monthly advice letter with the CPUC to adjust their rates according to their procurement costs. Electric utilities also change their rates according to the price they pay to procure electricity, but they typically adjust their rates less frequently—only once or twice each year—to reflect their forecasted energy costs. Further, the CPUC must approve electricity procurement through a separate hearing and not just through an advice letter.

The CPUC also uses different processes for determining natural gas rates and electricity rates after it has authorized the costs through a general rate case proceeding, though the processes are functionally similar. For electricity, a second phase of the general rate case proceeding determines the specific rates that the utility will charge its different classes of customers, such as residential customers and commercial customers. Gas utilities, meanwhile, do not participate in the second phase of the general rate case proceeding. Instead, gas utilities have separate proceedings to allocate their costs through the rates they charge to customers. Both types of utilities identify the rates that they charge customers in sheets called *tariffs*, which the utilities must file with the CPUC, maintain, and publish as directed by the CPUC. These tariffs contain pertinent information, such as the per-unit rate of gas and electric service for each customer class.

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Chapter 1

A CONFLUENCE OF FACTORS HAVE CONTRIBUTED TO RECENT INCREASES IN ELECTRICITY AND NATURAL GAS UTILITY RATES

Key Points

- From 2022 to 2023, electric utilities significantly raised the rates their customers pay. The CPUC had authorized through the general rate case process a number of expected higher utility operating costs that contributed to these rate increases. However, the majority of these rate increases were the result of growth in energy costs and the differences between the electric utilities' forecasts for certain costs and the actual costs that they incurred.

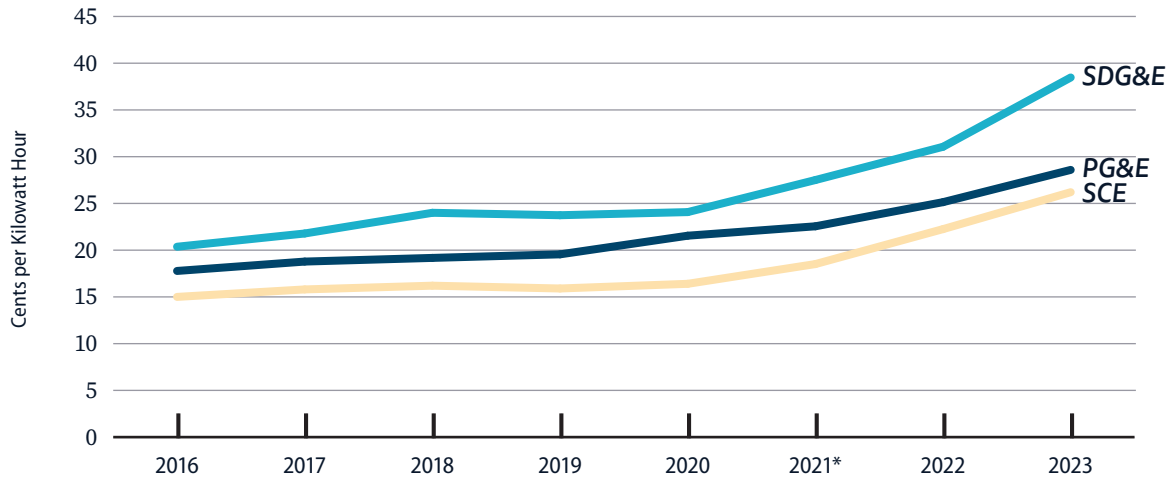
- Factors not entirely within the utilities' control have contributed to the recent electricity rate increases. Specifically, all three electric utilities have increased their spending on wildfire mitigation and natural disaster insurance. Further, some electric utilities' electricity sales have fallen as more of their customers have begun generating power from their own solar power systems, particularly for SDG&E.

- Although some natural gas utilities have experienced increased costs related to their distribution of natural gas to their customers, the significant jump in the rates that the natural gas utilities charged customers in 2022 was primarily caused by the rising cost of natural gas. A number of events, including the war in Ukraine, created volatility in the national and international natural gas markets that increased the price the utilities paid for the commodity.

Both Expected and Unexpected Increases in Utilities' Costs Contributed to the Recent Surge in Electricity Rates

The electricity rates of the three electric utilities whose general rate case proceedings we reviewed—SDG&E, PG&E, and SCE—have increased during the last seven years. For example, SDG&E's electricity rate nearly doubled, from 20 cents per kilowatt hour in January 2016 to 38 cents per kilowatt hour in January 2023. As Figure 5 shows, these increases have been particularly steep in the last two years, and more than a third of SDG&E's 18-cent increase took place from January 2022 through January 2023, during which time the rate increased by 7 cents per kilowatt hour. The other two electric utilities implemented similar increases. Although the CPUC authorized in advance through the general rate case proceeding the revenue requirements resulting in some of the recent rate increases, most were the result of the rising cost of procuring electricity and the differences between the utilities' forecasted and actual spending for other non-procurement-related costs that utilities pass on to customers.

Figure 5
Electricity Rates in California Have Increased by More Than 50 Percent During the Last Seven Years



Source: CPUC data used to generate its legislative report and utility advice letters.
Note: Further information on increases from January 2022 through January 2023 are shown in Table 2.
* SDG&E's rate listed here is as of March 2021 because of additional rate increases filed in February 2021.

Through the General Rate Case Proceeding, the CPUC Authorized Increases in Electric Utilities' 2022 Operating Costs

Growth in the electric utilities' forecasted total operating expenses—their cost of doing business—that CPUC authorized through general rate case decisions has contributed both to the overall increase in rates during the past seven years and to the upturn that began in 2021 and continued into 2023. On average, the electric utilities' operating expenses make up roughly half of the rates they charge their customers, with the other half resulting from other factors, including the costs of procuring electricity and the undercollection and overcollection of previously authorized costs. As a result, changes in utilities' operating expenses can significantly affect their rates. As Figure 6 shows, all three electric utilities' total operating expenses have increased over the course of their last three general rate case cycles.

General Rate Case Decisions We Reviewed

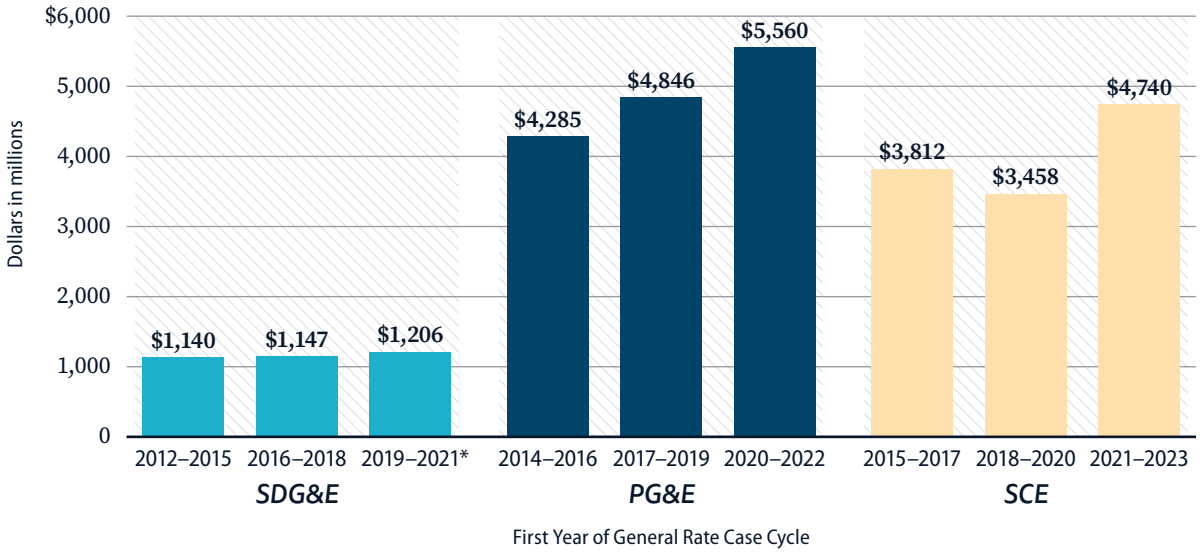
We reviewed the CPUC's general rate case decisions that authorized utilities' costs for the following time periods:

- SDG&E: 2019 through 2023
- PG&E: 2020 through 2022
- SCE: 2021 through 2023
- SoCal Gas: 2019 through 2023

Source: CPUC general rate case decisions.

The CPUC authorized increases in these utilities' total operating expenses during their last three general rate case cycles that ranged from roughly 6 percent for SDG&E—from $1.1 billion in 2012 to $1.2 billion in 2019—to 30 percent for PG&E—from $4.3 billion in 2014 to $5.6 billion in 2020. The utilities file rate case applications that begin on different years, as the text box shows; therefore, general rate case decisions cover different years for each utility. The CPUC's decisions on the utilities'

Figure 6
Electric Utilities' Operating Expenses Have Increased During the Last Three General Rate Case Cycles



Source: CPUC general rate case decisions.

* SDG&E's general rate case from 2019 relates to five years: 2019 through 2023. The CPUC's initial decision adopted revenue requirements for 2019 through 2021, and it later modified the 2019 rate case decision to authorize operating expenses for 2022 and 2023.

applications identify the cost categories included in the total revenue requirement it authorizes, allowing us to determine which categories increased the most. For example, the CPUC's decision on SDG&E's general rate case application for 2019 through 2021 included a summary of SDG&E's earnings for its electric operations that identified 19 categories of costs that make up its total operating expenses. These expenses included such cost categories as distribution, procurement, and support services.

The text box defines four categories of costs that were primary drivers of the increases in utilities' authorized total operating expenses in their most recent general rate case applications. Table 1 shows the changes in these categories of expenses that the CPUC authorized during the three electric utilities' most recently approved general rate case proceedings.

Common Significant Cost Categories

Distribution: Cost of building and maintaining a system that includes substations, circuits, poles, above ground and underground systems, and other components to distribute electricity; or a network of pipelines and associated pipeline facilities to distribute natural gas to customers.

Administration: Costs associated with accounting, finance, legal services, regulatory affairs, and external affairs.

Depreciation and Amortization: Costs of assets (plant, property, and equipment) spread over the used and useful life of those assets.

Taxes Other Than on Income: Estimated expenses for a utility's payroll tax liability, the tax applied to the assessed value of a utility's property, and franchise fees paid to counties and cities to place pipes, facilities, or other equipment within public rights-of-way.

Source: CPUC general rate case decisions.

Table 1
Four Expense Categories Have Contributed Substantially to Increases in the Electric Utilities' Operating Expenses

	CHANGES IN ELECTRIC UTILITIES' AUTHORIZED COSTS BETWEEN GENERAL RATE CASE PROCEEDINGS*		
	SDG&E	*PG&E*	*SCE*
COST CATEGORY	*from* **2016** (2016–18) to **2019** (2019–21)†	*from* **2017** (2017–19) to **2020** (2020–22)	*from* **2018** (2018–20) to **2021** (2021–23)
TOTAL OPERATING EXPENSES	**$59M, or 5%**	**$715M, or 15%**	**$1.3B, or $37%**
	Increase from $1.147B to $1.206B	**Increase from $4.846B to $5.560B**	**Increase from $3.458B to $4.740B**
Distribution	$28M, or 22%	$348M, or 49%	$132M, or 27%
	From $127M to $155M	From $710M to $1.058B	From $497M to $629M
Administration	$32M, or 10%	$236M, or 36%	$468M, or 77%
	From $313M to $345M	From $654M to $889M	From $608M to $1.076B
Depreciation and Amortization	$62M, or 17%	$243M, or 13%	$329M, or 21%
	From $374M to $436M	From $1.915B to $2.157B	From $1.579B to $1.909B
Taxes Other Than on Income‡	$21M, or 28%	$64M, or 16%	$82M, or 26%
	From $76M to $98M	From $395M to $459M	From $315M to $398M

Source: CPUC general rate case decisions.

Note 1: The CPUC's general rate case decisions also included cost categories beyond those shown above. Some of these other categories included costs that decreased. As a result, the sum of the four cost categories listed in the table will not match each utility's total operating expenses.

Note 2: The CPUC's decision on SDG&E's general rate case included significant adjustments for services that were to be shared between affiliated entities. The CPUC's decision did not provide sufficient supporting documentation to determine the expense categories to which these adjustments applied, and we did not attempt to obtain this information from the utility; however, these adjustments could have a significant impact on the numbers presented above for SDG&E.

* Due to rounding, the totals may not add up.

† SDG&E's general rate case from 2019 covered five years: 2019 through 2023. The CPUC's initial decision adopted revenue requirements for 2019 through 2021, and the CPUC later modified the 2019 rate case decision to authorize operating expenses for 2022 and 2023.

‡ Unlike the CPUC's general rate case decisions for SDG&E and SCE, the general rate case decision for PG&E does not include a line for "Taxes Other Than on Income." The total we show here for PG&E combines the revenue requirements that the CPUC approved for PG&E's property tax, payroll tax, business tax, other tax, and state corporation franchise tax.

In recent years, the administration category has contributed the most to the general rate case increases in electric utilities' authorized operating costs—nearly $736 million in total for the rate case proceedings in Table 1. This category consists of costs of a general nature or for overhead functions, including accounting, finance, regulatory affairs, and legal costs. In the most recently approved general rate case proceedings, the CPUC authorized administrative costs that ranged from 10 percent to 77 percent higher than the costs in that category it had authorized in each utility's previous general rate case. As Table 1 shows, SDG&E's administration costs increased the least (10 percent), while SCE experienced the largest increase in that category (77 percent). According to SDG&E's documentation, the two largest contributors to the increase in its administration costs were employee pension costs and property insurance.

In the most recent general rate case proceedings, the CPUC also authorized increases in the utilities' distribution costs. These increases ranged from 22 percent to 49 percent, as Table 1 shows. The reasons for these increases differed from utility

to utility. For example, the largest contributors to SDG&E's proposed increase in electricity distribution costs were in the four areas the text box defines—construction services, electric regional operations, asset management, and electricity distribution operations. In contrast, the single largest factor contributing to PG&E's $348 million increase in distribution costs was in its tree trimming balancing account.

Selected Aspects of SDG&E's Electricity Distribution Function

Construction Services: Provides oversight of all construction performed by contractors on electricity distribution to ensure that all work is built to SDG&E safety standards and in accordance with CPUC general orders.

Electric Regional Operations: Maintains the electricity distribution system, restores service after outages, fixes service problems and other customer issues, and constructs new electric infrastructure.

Asset Management: Creates and develops SDG&E's strategic asset management capabilities by assessing, leveraging, and integrating improvement work and creating new asset management capabilities.

Electricity Distribution Operations: Has operational control of the distribution system through SDG&E's electric operations control center for planned and unplanned work or outages, and emergency operations.

Source: SDG&E documentation supporting its general rate case applications.

The CPUC also authorized increased costs for electric utilities' depreciation and for certain taxes during their most recent general rate case proceedings. *Depreciation* is an accounting concept for allocating the expense of certain tangible or physical assets—property, plant, and equipment—over those assets' useful lives. Utilities reduce an asset's value in their accounting records, referred to as the *accumulated depreciation*, by an established amount each year, referred to as the *depreciation expense*, instead of recognizing the full cost of the asset at the time of purchase. The text box provides a simplified example of this concept.

Hypothetical Depreciation Example

In 2020, a utility invests $1 million in equipment for generating electricity from wind. This equipment is expected to have a useful life of 20 years. If the utility expects to sell the used equipment for $100,000 at the end of that time, the equipment has a depreciable cost of $900,000. Using the straight-line method of depreciation, the utility recognizes one-twentieth of the depreciable cost of the equipment—or $45,000—each year for 20 years. Thus, the utility may claim an expense of $45,000 each year for the next 20 years, rather than the $1 million in 2020.

Source: California State Auditor.

If utilities increase the value of their portfolio of physical assets, the amount that they can depreciate each year also grows. For example, SDG&E provided documentation showing that it expected an increase in the value of assets that it uses to support only its electric operations from $7.6 billion in 2016 to $9.1 billion in 2019. For this same period, it expected that its depreciation costs for the assets it does not share with its natural gas operations and its parent company would increase from $280 million to $340 million.[5]

Some of the utilities' recent increases in depreciable assets may be the result of their upgrading their assets to reduce the likelihood of wildfire. For example, in a recent decision, the CPUC cited an SCE estimate of the costs for upgrading its lines to covered conductor—a change that significantly reduces the risk of power lines causing a wildfire—at an average cost of $421,000 per mile. As utilities replace older assets like

[5] SDG&E also identified $58 million in proposed costs for 2019 that were related to items such as information technology hardware that it shares with one or more of the other entities with which it is affiliated, such as SoCal Gas.

power lines that have been fully depreciated, the amount that the utility claims in depreciation increases. In the next chapter, we discuss utility wildfire mitigation cost trends in additional detail.

SDG&E expected the value of the electricity generation and distribution assets on which it pays taxes to increase from $4.6 billion in 2016 to nearly $6.0 billion in 2019. This increase in asset value was echoed by an expected increase in its property tax liability of nearly $26 million during the same period.

Using information from SDG&E's and SCE's most recent general rate case proceedings, we determined that the CPUC authorized overall increases in the amount of revenue the utilities could collect during 2023 that ranged from $85 million, or 3.7 percent, for SDG&E to $437 million, or 6 percent, for SCE.[6] However, the actual increases in the utilities' rates as of January 2023 were significantly larger than the increases in the utilities' revenue requirements as authorized in their general rate cases. In the following section, we describe some of the reasons.

During 2022 Various Unanticipated Factors Increased Utility Rates

From January 2022 to January 2023, utilities received approvals to increase electricity rates by 16 percent to 23 percent, as Table 2 shows.[7] However, the increases attributed to general rate case proceedings—those that we discuss in the previous section—explain only 10 percent to 30 percent of the utilities' respective revenue requirements that increased. To determine why the rates increased by more than the amounts attributable to the CPUC's general rate case decisions, we reviewed the advice letters that the utilities submitted to the CPUC describing their justifications for changes subsequent to general rate case decisions. The advice letters describe both increases (revenue requirements that increased) and decreases (revenue requirements that decreased). We identified the three largest factors, other than the general rate case decision, that utilities' advice letters described as contributing to increases in their revenue requirements and thus the rate increases from January 2022 to January 2023. In total, the factors that we reviewed account for between 42 percent and 86 percent of each utility's revenue requirements that increased as of January 2023.

6 PG&E's most recent general rate case decision covers the years from 2020 through 2022, and the CPUC has not yet authorized PG&E's 2023 general rate case revenue requirement. However, the CPUC authorized PG&E to use memorandum accounts to track any overcollection or undercollection in rates retroactively to January 1, 2023, until the CPUC authorizes PG&E's next general rate case.

7 Because there are changes in the general rate case proceeding that add to rates and changes that decrease rates, the amounts in Table 2 do not match the sum of the changes for categories that we highlight in Table 1.

Table 2
CPUC General Rate Case Decisions Account for Only 10 Percent to 30 Percent of the Significant Electricity Rate Increases at the Beginning of 2023

	(Dollars per Kilowatt hour)						
	SYSTEM RATE 1/1/2022*	SYSTEM RATE 1/1/2023*	DOLLAR INCREASE	PERCENT INCREASE	SELECTED ITEMS FROM UTILITY ADVICE LETTERS THAT INCREASED	PRIMARY REASONS FOR INCREASE	TOTAL DOLLAR INCREASE AND PERCENTAGE OF TOTAL INCREASES *(in millions)*
SDG&E†	0.31	0.38	0.07	23%	Base Transmission Revenue Requirement	Increase in cost of transmission for 2023	$119 (12%)
					Energy Resource Recovery Account (balancing account)	Recovery of prior years' higher-than-expected costs of fuel and purchased power	107 (11%)
					General Rate Case	Authorized increase	97 (10%)
					Local Generating Balancing Account	Expiration of a prior year's offset for local generation	92 (9%)
PG&E	0.25	0.29	0.04	16%	General rate case	Authorized increase	1,557 (30%)
					Energy Resource Recovery Account forecast	Increase in forecasted cost of fuel and purchased power for 2023	1,446 (28%)
					Energy Resource Recovery Account (balancing account)	Recovery of prior year's higher than expected cost of fuel and purchased power	548 (11%)
					Transmission Owner Base Retail Revenue Requirement	Increasing cost of transmission	358 (7%)
SCE	0.22	0.26	0.04	18%	Energy Resource Recovery Account forecast	Increase in forecasted cost of fuel and purchased power for 2023	1,434 (36%)
					General Rate Case	Authorized increase	1,048 (26%)
					Energy Resource Recovery Account (balancing account) and Portfolio Allocation Balancing Account	Recovery of prior years' higher-than-expected costs of fuel and purchased power	617 (16%)
					Energy Efficiency	Increase in spending on energy efficiency programs	292 (7%)

Source: Utility advice letters, utility staff, utility worksheets supporting application information, CPUC advice letter dispositions, CPUC staff, and CPUC decisions.

Note 1: The amounts in this table that relate to general rate cases do not match the amounts in Table 1 because a general rate case authorizes different revenue requirements for different years. The general rate case costs in this table are all costs that the CPUC authorized for 2023, which was not the first year of any of the utility's general rate cases that we present in Table 1.

Note 2: The amounts in this table show the sum of cost increases related to the general rate cases and the three largest increases in the utilities' revenue requirements from January 1, 2022, through January 1, 2023, from the information reported by the utilities and published on the CPUC's website.

* System rate is a combination of the rates for all of the customer classes, such as residential, commercial, agricultural, and industrial; individual rates will vary depending on the specific rate schedule, such as tiered rates or time-of-use rates.

† See Appendix A for additional information about SDG&E.

Some of the most significant reasons for the unexpected rate increases in 2022 involved differences between the utilities' forecasted and actual costs. Utilities account for some categories of costs—such as the cost of purchasing energy—through the use of balancing accounts. Significant differences between forecasted and actual amounts in balancing accounts may be the result of various factors, such

as a utility's selling less electricity than it projected in its general rate case or other proceedings, or a utility's unanticipated costs. For example, certain events that started in 2021, such as a foreign war and abnormal weather, began driving up California's natural gas prices to well above historical norms. Because about 40 percent of the electricity produced within the State uses natural gas, this led to increased costs that utilities eventually pass on to customers in the form of higher rates.

Because SDG&E's rates increased by a greater percentage in 2022 than those of the other utilities, we provide in Appendix A additional detail about the elements that contributed to its rate increases. As Table 2 shows, SDG&E's rate increases were the result of growth in a number of its cost categories. First, an increase in its transmission costs accounted for $119 million, or 12 percent, of its increased revenue requirements.[8] SDG&E attributed the increase in transmission costs primarily to an increase in the prior-year revenue requirement, caused by higher operations and maintenance expenses, depreciation expenses, property and payroll taxes, and a higher transmission rate base. These transmission costs are regulated and approved by the Federal Energy Regulatory Commission (FERC). Next, SDG&E's actual costs for certain fuel needed to generate electricity and for electricity purchases for 2022 were $107 million higher than the forecasted amount that the CPUC approved. Because these costs are tracked in a balancing account, SDG&E subsequently passed the costs on to customers through a rate adjustment. The CPUC estimated that this difference alone required an increase in the average SDG&E residential electricity bill by $20.36 each month.

The final category for SDG&E relates to the removal of a prior-year reduction to the revenue requirement. In 2018 and 2019, SDG&E collected more than the CPUC had authorized on a program for local electricity generation. According to SDG&E, this overcollection was driven in part by lower costs for purchased power. The CPUC authorized SDG&E to reduce its revenue requirement by the $92 million that it had overcollected starting on January 1, 2022, which offset other increases in the rates. However, by January 1, 2023, SDG&E had spent the overcollected amount and had a slight undercollection in this account; therefore its revenue requirement increased.

Both of the other utilities experienced increases in their costs because of the cost of energy. PG&E's 2022 authorized revenue requirement reflected a forecasted cost for fuel and purchased electricity of $2.6 billion. However, PG&E anticipates that it will need more than $4 billion for these items. As a result, it also needed to increase its rates to account for this additional $1.4 billion. Similarly, SCE collected nearly $617 million less in 2022 than the costs of the fuel and purchased power it procured and accounted for in one balancing account. It consequently needed to collect this shortfall from customers. In addition to the amount that it undercollected in the prior year, SCE requested and the CPUC authorized it to collect an additional $1.4 billion during the following year for anticipated costs of the same type. The anticipated costs for the following year accounted for 36 percent of its revenue requirements that increased from January 2022 to January 2023.

[8] The amounts that we present are the largest increases of individual cost categories in the revenue requirement from January 1, 2022 to January 1, 2023, as reported by the utility and published on the CPUC's website.

Broader Energy Market Trends Have Placed Pressure on Electricity Rates

Factors that utilities cannot always directly control have also affected their rates during recent years. For example, all three electric utilities have reported increased spending since 2019 on wildfire mitigation costs and other emergency-related costs, such as insurance. Moreover, increasing numbers of electric utility customers are generating electricity from solar power systems and requiring less electricity from utilities. Because many of the utilities' costs do not vary with the amount of electricity that customers consume, utilities must increase the rates they charge for the electricity they do sell, in the absence of other cost savings, as their sales of electricity decrease. Finally, a variety of events have led to higher prices for the natural gas that is used to generate a significant portion of the State's electricity. Utilities pass on to customers the cost of procuring this energy. These factors—which are not always described in general rate case proceedings because they may occur over longer or shorter periods than the general rate case cycle—have contributed to the rate changes we describe above.

Electric Utilities Have Spent Significant Sums to Mitigate Wildfire Risks

The CPUC and some of the electric utilities we reviewed explained that wildfire mitigation expenses have contributed to the increases we observed in the utilities' operating expenses, which in turn have contributed to higher electricity rates. Specifically, in response to a CPUC request for data on wildfire and other catastrophic event-related costs—which included those data involving the utilities' operations, infrastructure, and insurance—the utilities reported that such costs comprise a growing portion of their revenue requirements. Some of these costs are for activities that utilities have traditionally performed to maintain their equipment, such as tree trimming; however, utilities are now performing more of this work and specifically categorizing it as a wildfire expense. In its *2022 Senate Bill 695 Report: Report to the Governor and Legislature on Actions to Limit Utility Cost and Rate Increases Pursuant to Public Utilities Code Section 913.1* (2022 legislative report), the CPUC highlighted these costs—which in 2021 ranged from $323 million for SDG&E to more than $2.6 billion for PG&E—as a key reason for recent rate increases.

Our review of data that the CPUC collected from utilities for the 2022 legislative report confirmed that the utilities' wildfire mitigation costs have generally been increasing. The costs that utilities reported varied widely, which may reflect the different geographical sizes, numbers of customers, and climates of the areas they serve. All three reported increased wildfire spending from 2019 through 2021; however, PG&E and SCE in particular reported rapid and generally larger increases in their wildfire mitigation and insurance costs. As Table 3 shows, in 2019 PG&E identified less than $100 million (less than 1 percent of its total revenue requirement) in wildfire mitigation, wildfire insurance, and catastrophic events costs in its revenue requirement, but it reported to the CPUC that nearly $2.7 billion (18.5 percent of its revenue requirement) for 2021 was for those purposes. SCE similarly reported that by 2021, its costs for these purposes had grown from $289 million (2.6 percent of its

revenue requirement) to $1.7 billion (12 percent of its total revenue requirement). SDG&E, on the other hand, reported a much smaller increase in its costs in this area, from just 3 percent of its revenue requirement in 2019 to 7.5 percent in 2021.

Table 3
Wildfire Mitigation, Wildfire Insurance, and Catastrophic Event Costs Represent an Increasing Percentage of Electric Utilities' Total Revenue Requirements (calendar years 2019 through 2021)

	SDG&E			PG&E			SCE		
	2019	2020	2021	2019	2020	2021	2019	2020	2021
Total Revenue Requirement (in millions)	$4,212	$4,142	$4,335	$13,562	$14,146	$14,382	$11,121	$12,665	$14,294
Total Wildfire Revenue Requirement (in millions)	126	183	323	74	743	2,655	289	1,006	1,718
Wildfire Revenue Requirement As a Percentage of Total Revenue Requirement	3.0%	4.4%	7.5%	0.5%	5.3%	18.5%	2.6%	7.9%	12.0%

Source: CPUC's 2022 Senate Bill 695 Report, confirmed through a comparison to information provided by utilities to the CPUC.

Note: Wildfire mitigation costs were not discretely presented in utilities' latest approved general rate case applications; therefore, we could not verify these amounts relative to the revenue requirements we reviewed for the three utilities.

According to the CPUC, SDG&E invested significantly in various efforts to better address the risk of wildfires from 2007 to 2018 in reaction to the wildfires in 2007 in its service area. Although SDG&E's reported costs in wildfire mitigation, insurance, and catastrophic events increased by nearly $200 million from 2019 to 2021, its earlier investments in this area may explain why its costs increased at a slower pace than PG&E's and SCE's costs during this period. Although the CPUC could not verify SDG&E's wildfire mitigation-related spending from 2007 to 2018, it estimated that it authorized as much as $1.7 billion in these costs for SDG&E during this period.[9] The CPUC explained that these costs were not required to be identified and tracked separately and that it would not be feasible to identify those that occurred prior to 2019. Further, the CPUC asserted that costs cannot be traced to specific advice letters implementing rates, so the CPUC could not identify these costs prior to 2019. Cal Advocates staff similarly explained that as a result of wildfires and related litigation, SDG&E had to invest in wildfire mitigation projects earlier than did other utilities. In reviewing the utilities' tariffs, we verified that from 2013 through 2018, SDG&E's rates increased faster than both inflation and the other two electric utilities' rates, suggesting that during that time, it was incurring higher costs than the other utilities for certain purposes.

[9] In 2018, the Legislature passed legislation governing utilities' requests for and reporting of wildfire mitigation costs as part of a broader law to improve forest health and reduce the risk of deadly wildfires. State law required utilities to prepare and follow wildfire mitigation plans and allowed utilities to track and recover the related costs in their rates. We discuss wildfire mitigation costs in more detail later in this report.

Although SDG&E's reported wildfire mitigation costs from 2019 through 2021 were less than those of PG&E and SCE, natural disaster risks have affected its rates in other ways. The cost data that SDG&E provided the CPUC suggests that its costs related to wildfire insurance and other catastrophic events, such as a 2020 heat wave, increased from nearly $89 million in 2019 to almost $250 million in 2021. This is a nearly 300 percent growth in costs related to wildfire insurance and catastrophic events.

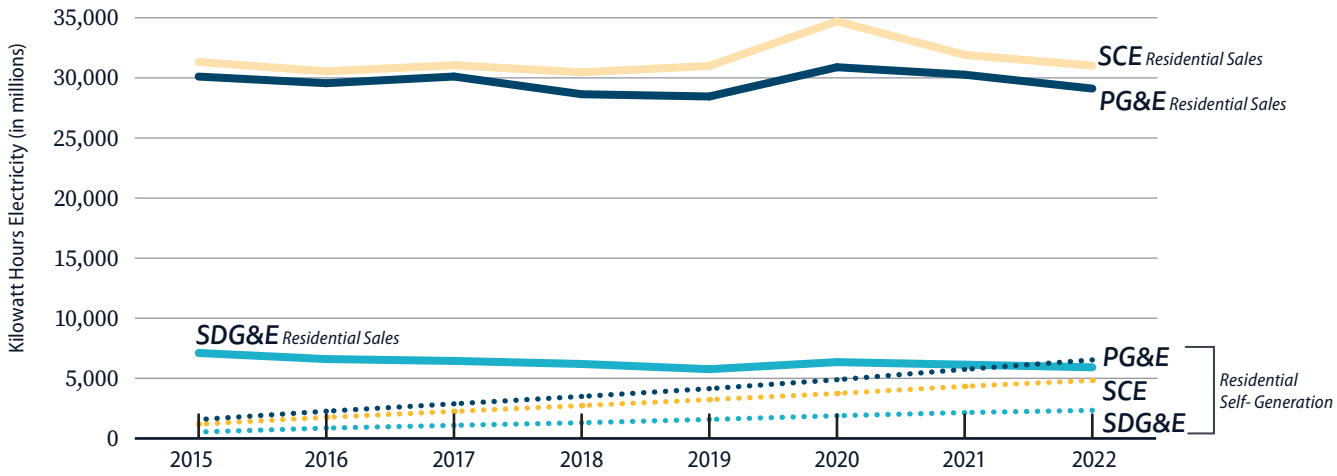
Increased Use of Solar Power Systems Has Contributed to Electricity Rate Increases

As an increasing number of customers install solar power systems to generate electricity, the utilities have had to compensate for the resulting loss in revenue by increasing their rates to recover certain fixed costs. The amount of electricity that a utility procures for customers affects the rates it charges customers because it is generally allowed to collect funding equal to its required revenue. Most residential and small commercial electricity rates are charged to customers by way of volumetric rates. This type of rate is charged to customers on a cents-per-kilowatt-hour basis, causing customers' bills to vary according to how much energy they consume.[10] However, many infrastructure and operational costs—such as maintaining the transmission and distribution lines connecting customers to the electrical grid—that are paid for by the volumetric rate are fixed costs: they do not change if the customers connected to the electrical grid purchase less electricity from the utility. Customers generating their own electricity by using solar power systems reduce the amount of electricity that a utility sells, which the CPUC and Cal Advocates have both concluded leads to utilities' increasing their rates to compensate. Such increases generally affect all residential customers, although all other things being equal, households that generate some of their own electricity likely have lower electricity bills because they purchase less electricity.

Available data show that the utilities' electricity sales have generally been declining in recent years as the number of customers adopting solar power systems has increased. As Figure 7 shows, SDG&E customers have increased their personal electricity generation in recent years, primarily through solar power installations. According to data from the California Energy Commission, the amount of electricity self-generated by residential customers in the three electric utility service areas totaled more than 10.5 billion kilowatt-hours in 2020. Over the same time, utilities have generally experienced a decline in residential electricity sales. For example, in SDG&E's service area, residential customers self-generated about 1.9 billion kilowatt-hours of energy in 2020—equivalent to the annual energy consumption of about 170,000 average American households—which is a dramatic increase from 535 million kilowatt-hours in 2015. During the same time, SDG&E's residential electricity sales decreased by nearly 760 million kilowatt-hours, or about 11 percent. Although other factors may be responsible for the decline in electricity sales, the fact remains that the electricity sales have declined as self-generated electricity has increased.

[10] Utilities typically express electricity usage statistics and sales in kilowatt-hours, and an average American household consumes about 11,000 kilowatt-hours of electricity annually.

Figure 7
Utilities' Residential Electricity Sales Decreased as Self-Generation Increased



Source: California Energy Commission (CEC) 2022 and 2023 energy forecasts for the respective utilities.

Notes: All three utilities experienced an increase in residential electricity use in 2020, likely due to households spending more time at home because of the COVID-19 pandemic.

Self-generated energy data for 2021 and 2022 are estimates, and sales data for 2022 are estimates that the utilities provided to the CEC.

Data for residential sales is from 2022 CEC information and residential self-generation is from 2021 CEC information.

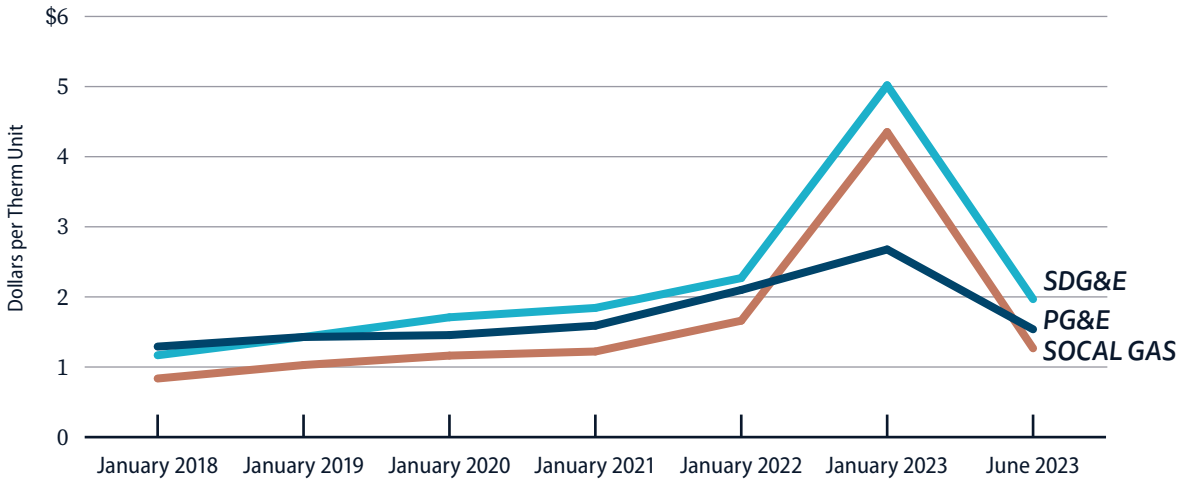
The Rising Cost of Natural Gas Has Driven Increases in Customers' Natural Gas Rates

The rates of the three natural gas utilities we reviewed had increased significantly in recent years, as Figure 8 shows, but decreased by June 2023. In fact, SDG&E's and SoCal Gas's natural gas rates increased by 330 percent and 420 percent, respectively, from January 2018 through January 2023. During the same period, PG&E's natural gas rates increased by more than 100 percent. The vast majority of the increases for all three natural gas utilities occurred during the last two years. Although some of the rate increases resulted from the utilities' growing costs for transporting natural gas to customers, the rising cost of procuring natural gas was the single most important factor. By June 2023, the price of the natural gas commodity decreased, contributing to the overall decrease in rates.

Through the General Rate Case Proceedings, the CPUC Authorized Increases in the Natural Gas Utilities' Operating Costs

Similar to its authorizing the increases in electric utilities' operating expenses, the CPUC authorized increases in the natural gas utilities' operating expenses over the course of their last three general rate case cycles, as Figure 9 shows. These increases ranged from roughly 15 percent for PG&E—from $1.29 billion in 2014 to $1.48 billion in 2020—to 36 percent for SoCal Gas—from $1.66 billion in 2012 to $2.26 billion in 2019.

Figure 8
Natural Gas Rates in California Have Increased Significantly in Recent Years*



Source: Historical rate information provided by SoCal Gas's director of regulatory affairs, natural gas tariffs published on SDG&E's website, and customer rates published on PG&E's website.

* Rates shown are for bundled residential rates.

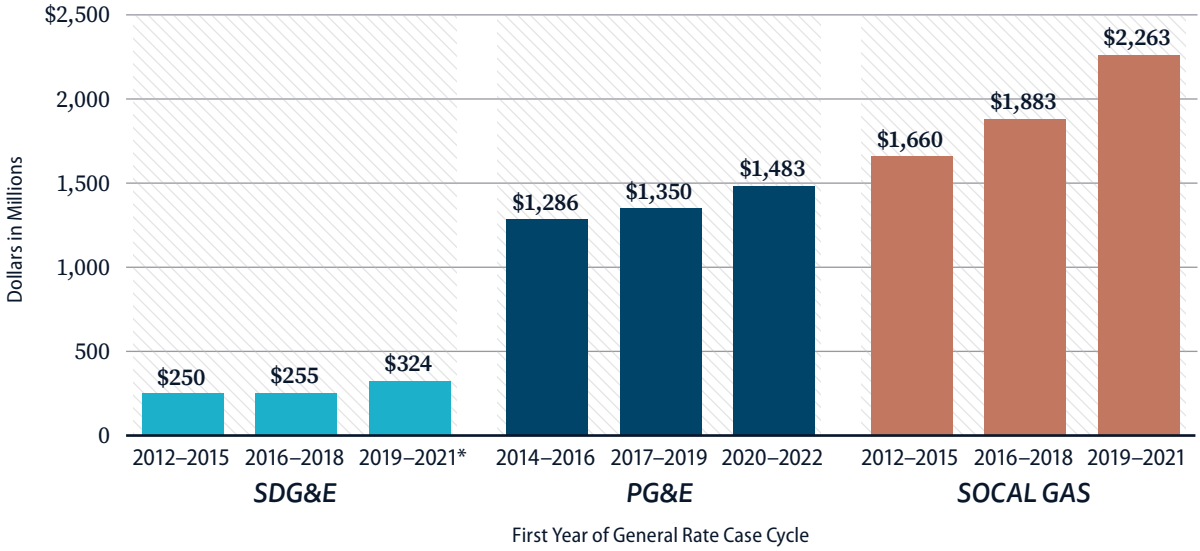
Table 4 illustrates the changes in natural gas utilities' authorized operating costs for the same categories Table 1 lists for electrical utilities: *distribution*, *administration*, and *depreciation and amortization*. In addition, Table 4 shows the changes in natural gas utilities' *transmission* costs—the costs of maintaining and operating the high-pressure pipelines and compressor stations to move the gas to the distribution system infrastructure that delivers natural gas to customers. The two largest increases in Table 4 correspond to the leading causes of the natural gas utilities' increased operating costs: increases in depreciation, which totaled nearly $245 million in the three natural gas utilities' most recently authorized rate cases, and increases in administration, which totaled more than $228 million.

The natural gas utilities' increases in depreciation costs appear consistent with the increase in the value of their depreciable assets. For example, in its 2019 rate case application, SDG&E reported that its depreciation cost for its natural gas operations would increase from $37 million in 2016 to $47 million in 2019.[11] SDG&E also reported that during this same period, the value of the assets it uses for natural gas storage, transmission, and distribution would increase from $1.6 billion to $2.0 billion.

SDG&E's documentation shows that two cost categories—employee pensions and medical benefits—were the largest contributors to the 11 percent increase in its administration costs. For example, in its 2019 rate case application, SDG&E proposed

[11] SDG&E also proposed that its natural gas operations recognize additional depreciation costs of $58 million from common assets, such as information technology hardware, that we described in footnote 5.

Figure 9
Natural Gas Utilities' Operating Expenses Have Increased During the Last Three General Rate Case Cycle



Source: CPUC general rate case decisions.

* The general rate case for SDG&E and SoCal Gas from 2019 relates to five years: 2019 through 2023. The CPUC's initial decision adopted revenue requirements for 2019 through 2021, and it later modified the 2019 rate case decision to authorize operating expenses for 2022 and 2023.

increasing its pension contributions from $582,000 in 2016 to $13 million in 2019. The amount of such contributions that the CPUC authorized increased significantly after the CPUC's decision on SDG&E's 2019 general rate case application, in which the CPUC directed SDG&E to address a pension-funding shortfall. The CPUC found that SDG&E's method for funding its employees' pensions had led to its benefit payments' exceeding its contributions. The 2019 decision authorized SDG&E to fund this pension shortfall over 14 years. SoCal Gas's documentation also indicates that its proposed increases in employee health and pension expenses were the primary contributors to its requested increase in administration costs.

Distribution costs were another significant contributing factor to SDG&E's and SoCal Gas's increased operating expenses. Generally, both cited higher workloads and the need for increased staffing as reasons for their proposed increases to their distribution costs. SDG&E proposed increases in asset management and field operations costs, which are parts of the distribution cost category. During its general rate case proceeding, SDG&E explained that many of the additional costs in these areas related to staffing, including hiring additional staff to perform planning and design activities, training and monitoring certain safety staff, and addressing other increases in the utility's workload. SoCal Gas's documentation shows that the three largest increases it requested in the distribution cost category were for field support, which includes field supervision, clerical employees, and dispatch employees; cathodic protection, which is a method for mitigating external corrosion on steel pipes; and the facilitation of emergency preparedness through effective, comprehensive, and responsive recovery programs.

Table 4
Five Expense Categories Contributed Substantially to Increases in Natural Gas Utilities' Total Operating Expenses

	CHANGES IN UTILITIES' AUTHORIZED COSTS BETWEEN GENERAL RATE CASE PROCEEDINGS*		
	SDG&E	PG&E	SOCAL GAS
COST CATEGORY	*from* **2016** (2016–18) to **2019** (2019–21)†	*from* **2017** (2017–19) to **2020** (2020–22)	*from* **2016** (2016–18) to **2019** (2019–21)†
TOTAL OPERATING EXPENSES	**$68M, or 27%**	**$134M, or 10%**	**$380M, or 20%**
	Increase from $255M to $324M	**Increase from $1.350B to $1.483B**	**Increase from $1.883B to $2.263B**
Distribution	12M, or 50%	-$50M, or -12%	$17M, or 12%
	From $24M to $36M	From $430M to $380M	From $135M to $152M
Transmission	$2M, or 43%	N/A‡	$27M, or 65%
	From $5M to $7M	(No approved expenditures)	From $41M to $68M
Administration	$8M, or 11%	$55M, or 21%	$165M, or 44%
	From $74M to $83M	From $259M to $314M	From $377M to $542M
Depreciation and Amortization	$23M, or 40%	$28M, or 6%	$194M, or 48%
	From $57M to $80M	From $480M to $508M	From $404M to $598M
Taxes Other Than on Income§	$7M, or 48%	$48M, or 67%	$30M, or 31%
	From $15M to $22M	From $71M to $119M	From $95M to $125M

Source: CPUC general rate case decisions.

Note 1: The CPUC's general rate case decisions also included cost categories in addition to those shown above. As a result, the sum of the four cost categories listed in the table will not match each utility's total operating expenses.

Note 2: The CPUC's decision on SDG&E and SoCal Gas's rate cases included significant adjustments for services that were to be shared between affiliated entities. The CPUC's decision did not provide sufficient supporting documentation to determine the expense categories to which these adjustments applied and we did not attempt to obtain this information from the utilities; however, these adjustments could have a material impact on the numbers presented above for SDG&E and SoCal Gas.

* Due to rounding, the totals may not add up.

† SDG&E's and SoCal Gas's general rate case for 2019 relates to five years: 2019 through 2023. The CPUC's initial decision adopted revenue requirements for 2019 through 2021, and it later modified the 2019 rate case decision to authorize operating expenses for 2022 and 2023.

‡ The CPUC authorized PG&E's 2019 through 2022 revenue requirement for gas transmission and storage in a separate proceeding from its general rate case for gas operating expenses. For 2019, CPUC authorized $484 million for PG&E's natural gas transmission expenses.

§ Unlike SDG&E and SoCal Gas's general rate cases, the general rate case decision for PG&E does not include a line for "Taxes Other Than on Income." The total we show here for PG&E combines the revenue requirements that the CPUC approved for PG&E's property tax, payroll tax, business tax, other tax, and state corporation franchise tax.

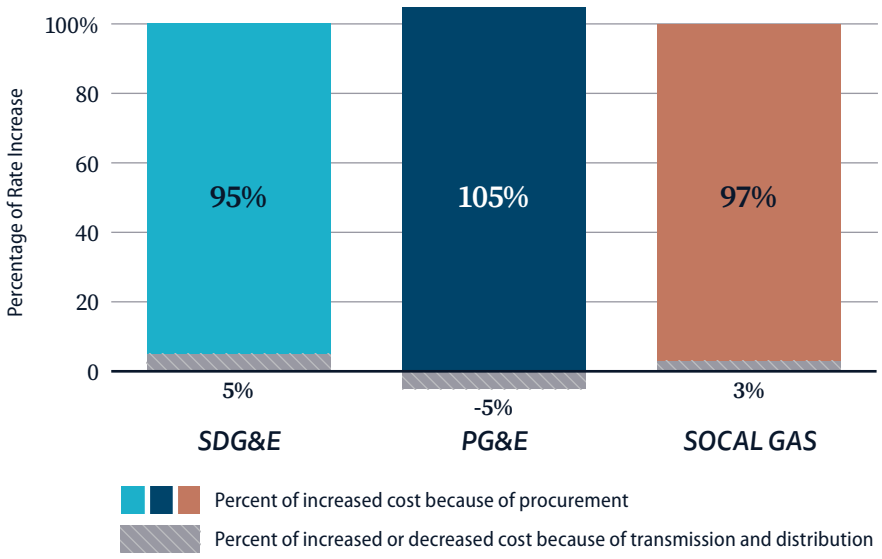
Rising Commodity Costs Have Significantly Affected Natural Gas Utility Rates

For all three utilities, the cost of procuring the natural gas they supplied to customers was the primary reason for the increase in their rates from January 2022 through January 2023.[12] Although natural gas prices fluctuated throughout 2022, the increase in the cost of procuring natural gas caused 95 percent or more of the utilities' respective increases in natural gas rates, as Figure 10 shows. For example, PG&E's

[12] Some large commercial and industrial customers purchase their own natural gas and only use the utilities' infrastructure to transport the gas; thus, these customers' utility rates do not include the price of the gas itself. For this reason, we limited our analysis to residential customers' rates.

natural gas rates rose from $2.10 per unit in January 2022 to $2.68 per unit in January 2023, an increase of 58 cents per unit.[13] Had PG&E not reduced its transmission costs by 3 cents per unit, this rate increase would have been 61 cents.

Figure 10
The Cost of Procuring Natural Gas Accounted for Nearly All of the Increases in Customer Rates From January 2022 Through January 2023



Source: Historical rate information provided by SoCal Gas's director of regulatory affairs; natural gas tariffs published on SDG&E's website; and customer rates published on PG&E's website.

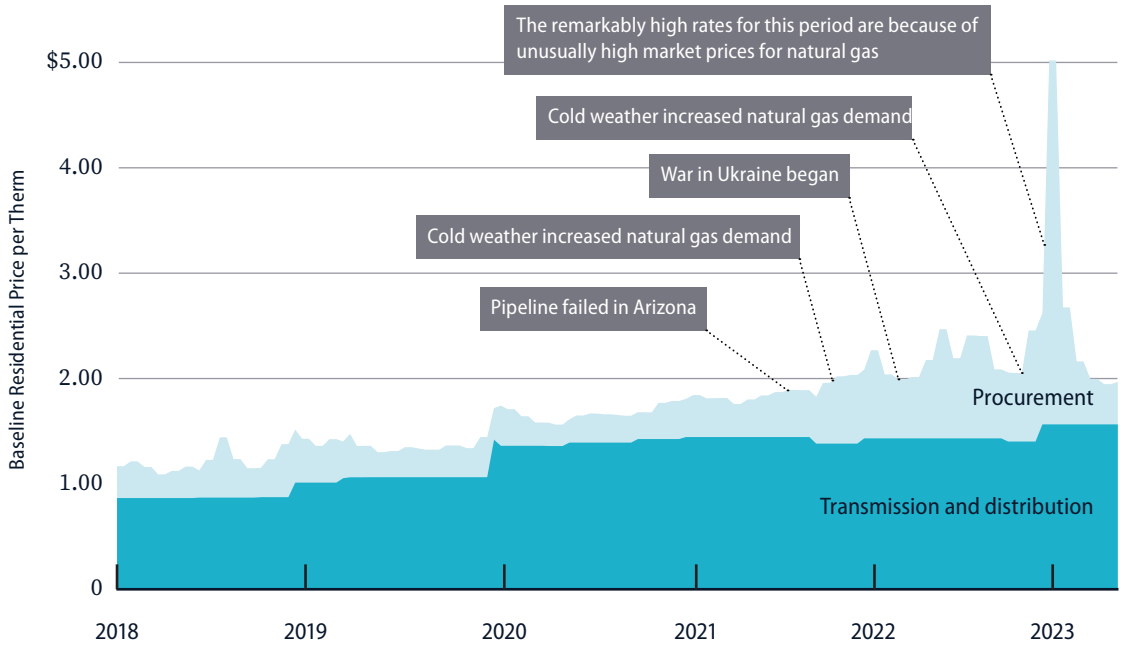
Notes: In the months after January 2023, the price of procuring natural gas decreased significantly. In March 2023 procurement costs represented, on average, only 63 percent of the difference in rates from March of the previous year.

This figure does not include some elements, such as daily fixed charges, transmission and distribution charge increases imposed when use exceeds a certain limit, and state regulatory fees and other program surcharges charged as required.

Utilities purchase natural gas through wholesale gas markets at prices that fluctuate according to national, and increasingly global, gas market supply and demand conditions. The estimates that SDG&E provided in response to a CPUC request show that the cost of the natural gas it purchased represented nearly 30 percent of its 2022 natural gas revenue requirement—a proportion that was nearly identical for SoCal Gas, which is a subsidiary of the same parent company as SDG&E. For that same year, data that PG&E provided indicate that the cost of the natural gas it purchased made up nearly 16 percent of its natural gas revenue requirement; this difference occurs in part because the transmission costs for the pipelines that SDG&E uses to transport gas from the State's border make up a larger proportion of its total revenue requirement. As Figure 11 illustrates, the cost of natural gas drove the fluctuations in SDG&E's natural gas rates in recent years.

[13] Utilities and regulators generally track natural gas in *therms*, which is a measure of the energy contained within the gas. One therm is equal to 100,000 British thermal units, or about the same amount of energy as 29 kilowatt-hours.

Figure 11
Significant Unforeseen Events Preceded Some Increases in SDG&E's Rates



Source: Natural gas tariffs from SDG&E's website, natural gas weekly update reports from the U.S. Energy Information Administration website, and the U.S. Department of Defense's website.

Nationwide natural gas prices in calendar years 2021 and 2022 were higher on average than they had been in recent years. Natural gas in 2021 was on average nearly 50 percent more expensive on a per-therm basis than in the previous five years. Prices remained elevated in 2022, with the prices that California utilities paid for natural gas spiking dramatically beginning in the winter of 2021 and persisting through early 2023. The rates for all three utilities we reviewed decreased significantly after January 2023. PG&E's natural gas rate for its customers decreased from $2.68 per unit in January 2023 to $1.54 per unit by June 2023. Similarly, SDG&E's rate decreased from $5.02 per unit to $1.97 per unit, and SoCal Gas's rate decreased from $4.35 per unit to $1.27 per unit.

The U.S. Energy Information Administration (EIA) identified factors that either constricted gas supply or increased demand beginning in 2021, including the unusually cold temperatures in early 2021 and early 2022 that created increased demand and elevated wholesale prices; the war in Ukraine, which caused uncertainty in the international natural gas markets starting in early 2022; and lower-than-average levels of natural gas in storage associated with these market impacts. For example, in the week following the beginning of the war in Ukraine in early 2022, the EIA reported that significant uncertainty in the international gas market drove European natural gas prices about 600 percent higher than they had been during the same week in spring 2021. Because imports and exports affect the wholesale price of natural gas, these prices affected U.S. prices.

Additionally, a pipeline rupture in Arizona significantly reduced the supply of natural gas to California beginning in August 2021. The EIA reported that the market price of gas in California was 230 percent higher in August 2021 than in August 2020. From October through December 2021, prices remained higher than they had been during any month in the previous decade.

Because utilities pass the procurement cost of natural gas directly to customers, market forces can cause a utility's natural gas prices to be highly volatile. Thus, at multiple points in the last three years, California natural gas customers experienced significant rate spikes following events that affected the market for natural gas. Moreover, similar external factors may affect natural gas prices in the future. To ensure the reasonableness of natural gas costs incurred on behalf of customers, the CPUC has created methods that incentivize reducing the costs that utilities pass on to customers. It has established a mechanism for annually calculating how each utility's actual costs for natural gas compare to a benchmark of the cost of gas intended to emulate actual market conditions on a monthly basis; if the utility can demonstrate that it purchased and transported gas for certain customers at prices equal to or less than prevailing market prices, the utility's shareholders retain a portion of the resulting cost savings. Through this mechanism, the utility can earn a reward even when prices are increasing if its cost is lower than the benchmark. For example, in 2022 the CPUC decided—and Cal Advocates verified—that from April 2020 through March 2021, SoCal Gas recorded natural gas costs that were $185 million below the benchmark. As a result, the CPUC authorized SoCal Gas $11 million in profits that it could retain for its shareholders.

The CPUC is also engaged in an ongoing effort, which we discuss in the Other Areas Reviewed section, to identify gas rate reforms to address the ramifications of a state-sponsored focus on customers' transitioning from natural gas to electricity. For example, the CPUC has solicited feedback on concepts such as establishing fixed charges in natural gas bills to mitigate increases in natural gas rates resulting from decreased sales. CPUC staff also indicated during a July 2023 rulemaking process that it will consider a SoCal Gas recommendation that it explore charges for customers who stop receiving natural gas service.

Chapter 2

THE CPUC AND CAL ADVOCATES NEED TO STRENGTHEN THEIR PROCESSES FOR OVERSEEING UTILITIES' COSTS AND ENSURING TRANSPARENCY

Key Points

- SDG&E has earned more than the CPUC's authorized rate of return in nine of the last 10 years. Although utilities may generally retain as profits the savings they generate from reducing operating costs below projections, SDG&E's consistently higher rate of return suggests that it may have overstated its forecasted costs during the general rate case. Reviewing how much utilities earn compared to the authorized rate of return and identifying where utilities are able to gain efficiencies should be a critical first step in ensuring that their proposed costs are appropriate, but the CPUC and Cal Advocates do not perform such a targeted review.

- When a utility files a cost recovery application, the CPUC and Cal Advocates could strengthen their processes for verifying whether that utility actually completed the activities associated with the costs. Without verifying—even for a selection of costs—that utilities have performed the activities in question, the CPUC and Cal Advocates risk allowing utilities to recover costs for activities they did not complete, which are costs that will in turn be passed on to customers.

- The CPUC does not clearly and comprehensively communicate to customers the reasons for rate increases. Developing a means of providing such information to the public will allow the CPUC to keep utility customers informed about rate changes and explain why it believes the rates it approves are fair and reasonable.

The CPUC and Cal Advocates Could Better Monitor the Costs That Utilities Propose

U.S. Supreme Court decisions have held that investor-owned utilities are entitled to earn a return on investment that is reasonable and sufficient to attract capital. As we explain in the Introduction, the CPUC authorizes the rate of return for each utility during a cost of capital proceeding. Cal Advocates represents the interests of customers during these proceedings. To do so, it currently hires a consultant to perform a cost of capital study for the four large utilities and to evaluate their rate of return testimony in the proceeding. The study examines various financial models and estimates the returns that investors require for other companies with similar levels of risk. In recent years, the CPUC has authorized utilities to earn about 7.7 percent or less of their rate base, which is generally the value of certain assets that a utility owns. For example, in 2021 SDG&E's rate base for electricity generation and distribution was $5.5 billion and the authorized rate of return was 7.55 percent.[14]

[14] This amount does not include transmission rate base components. The FERC is an independent agency that regulates the interstate transmission of electricity and other energy sources. Although the CPUC is required to allow recovery of all FERC-authorized costs, the transmission revenue requirements are determined in a separate proceeding. Furthermore, FERC-authorized revenue may also increase or decrease a utility's actual rate of return.

Thus, without any regulatory adjustments, SDG&E's revenue requirement could include a $415.5 million return on investment—an amount that it could collect from its customers through its rates.

A utility's actual rate of return may be higher or lower than the rate of return that the CPUC authorized in the cost of capital proceeding, depending in part on how the utility manages its operations and the costs authorized in the general rate case proceeding. In a 1996 decision, the CPUC observed that an investor-owned utility may retain as profits the savings it generates from reducing operating costs below projections in the general rate case proceeding. For example, utilities may find efficiencies in labor or administrative costs. However, with limited exceptions, the utility must also bear the additional costs when those costs exceed projections. Thus, if a utility's actual costs end up lower than the costs included in its authorized revenue requirement, then the utility's actual rate of return will be higher than the authorized rate of return.

This provides an incentive for utilities to efficiently manage their operating costs and could also lower future costs for utilities and rates for customers. However, we are concerned that this arrangement could also create perverse incentives because the CPUC uses forecasts of operating costs that utilities present and that are litigated through CPUC proceedings when approving rates, except when the CPUC requires the utilities to use a balancing account. According to multiple sources, ratemaking that is based on forecasts may expose ratepayers to overspending and overestimated costs because the utilities control and produce the information used in the forecasting process. Moreover, according to an updated study in 2015 by the Pacific Economics Group Research LLC, California is one of only 14 states that commonly use fully forecasted test years when determining rates.

As a result, utilities may have an incentive to generate profits by overestimating their operating costs and then characterizing the difference between their estimates and their actual costs as cost savings. The use of this practice could be indicated by actual rates of return consistently exceeding authorized rates of return. In fact, although the authorized rate of return has been trending downward for natural gas and electric utilities over the most recent years, SDG&E has consistently earned a higher rate of return than the rate the CPUC authorized, as Table 5 shows. SDG&E has typically exceeded the authorized rate of return by as much as 1.5 percentage points: for example, in 2021 its authorized rate of return was 7.55 percent, but it reported an actual rate of return of 8.08 percent. Depending on how SDG&E was able to gain efficiencies, this could represent about $29 million more in profit than the CPUC authorized. Although SoCal Gas earned less than the authorized rate of return in the two most recent years, it also exceeded the authorized rate of return in all other years we reviewed. In contrast, both PG&E and SCE earned an actual rate of return below their authorized rates of return in recent years.

Although a utility may reasonably earn more than the amount that the CPUC authorized, the fact that SDG&E has done so in nine of the last 10 years raises questions about whether forecasted costs were consistently overstated. SDG&E's consistently higher actual rate of return than authorized suggests that it may have overstated its forecasted costs during the general rate case proceeding. Reviewing

Table 5
In 14 of the Past 17 Years, SDG&E Has Realized Higher-Than-Authorized Rates of Return

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
SDG&E																	
Authorized	8.23	8.23	8.40	8.40	8.40	8.40	8.40	7.79	7.79	7.79	7.79	7.79	7.55	7.55	7.55	7.55	7.55
Actual	9.62	8.57	9.44	9.45	9.41	8.30	8.08	8.75	9.32	8.98	8.57	6.55	8.78	9.00	9.10	8.08	8.25
Difference	1.39	0.34	1.04	1.05	1.01	-0.10	-0.32	0.96	1.53	1.19	0.78	-1.24	1.23	1.45	1.55	0.53	0.70
PG&E																	
Authorized	8.79	8.79	8.79	8.79	8.79	8.79	8.79	8.06	8.06	8.06	8.06	8.06	7.69	7.69	7.58	7.34	7.34
Actual	8.97	9.27	9.16	8.67	8.64	7.73	6.51	6.24	7.50	7.01	8.39	7.50	-16.13	-15.46	2.72	5.29	5.76
Difference	0.18	0.48	0.37	-0.12	-0.15	-1.06	-2.28	-1.82	-0.56	-1.05	0.33	-0.56	-23.82	-23.15	-4.86	-2.05	-1.58
SCE																	
Authorized	8.77	8.77	8.74	8.74	8.74	8.74	8.74	7.90	7.90	7.90	7.90	7.90	7.61	7.68	7.68	7.68	7.68
Actual	8.45	8.92	7.74	9.32	8.86	8.17	9.32	8.79	9.46	7.60	8.10	5.81	0.70	6.73	4.40	3.91	4.00
Difference	-0.32	0.15	-1.00	0.58	0.12	-0.57	0.58	0.89	1.56	-0.30	0.20	-2.09	-6.91	-0.95	-3.28	-3.77	-3.68
SOCAL GAS																	
Authorized	8.68	8.68	8.68	8.68	8.68	8.68	8.68	8.02	8.02	8.02	8.02	8.02	7.34	7.34	7.30	7.30	7.30
Actual	10.83	10.23	10.33	11.52	11.15	10.08	9.38	11.03	9.66	10.52	9.09	8.38	7.93	10.58	7.88	-3.09	3.31
Difference	2.15	1.55	1.65	2.84	2.47	1.40	0.70	3.01	1.64	2.50	1.07	0.36	0.59	3.24	0.58	-10.39	-3.99

Source: CPUC website and financial documents provided by the respective utility.

how much the utility earned compared to the authorized rate of return and identifying where the utility was able to gain efficiencies should be a critical first step in ensuring that the utility's projected costs were appropriate. However, there is no process to identify areas in which the utilities achieved cost savings.

The CPUC asserted that there is an inherent control in its process that creates a disincentive for utilities to overstate their costs. In fact, it explained that a utility's efficiencies that result in increased profits will diminish the actual recorded amounts that the utility uses to determine forecasts during the following general rate case proceeding. The CPUC believes that various parties' review of forecasted costs and the recorded actual past costs during the general rate case proceeding provides important context for the commissioners to determine whether forecasted costs for the next cycle are reasonable.

Nonetheless, we are concerned that the CPUC is not providing sufficient safeguards to protect customers. SDG&E's and SoCal Gas's ability to earn higher-than-authorized rates of return for multiple years and through different general rate case cycles suggests that the CPUC's process for setting revenue requirements may not inherently self-correct, as the CPUC suggests. Furthermore, nothing precludes the CPUC from determining which costs a utility was able to reduce to achieve profits. This information could help the CPUC determine whether further scrutiny of the utility's proposed costs during future proceedings is warranted. Without fully understanding exactly how utilities are gaining cost-related efficiencies and earning profits, the CPUC cannot be certain that the revenue requirement it authorizes and the resulting rates are fair and reasonable.

Further, although the CPUC collects some information from the utilities regarding the rates of return they have earned, it does not do so consistently. The CPUC requests that electric utilities provide information regarding their actual rates of return, and it publishes this information on its website. However, the CPUC did not obtain and provide this information for SoCal Gas and could not tell us why it did not do so. Moreover, the CPUC has not instructed utilities on how to calculate their actual rate of return or on the data to use when calculating their actual rate of return because this instruction was not related to an official proceeding. The CPUC asserted that utilities have a legal obligation under its rules not to misstate such information. However, without sufficient controls in place, the CPUC risks that utilities may inconsistently or inappropriately calculate their rates of return.

In addition, Cal Advocates does not use utilities' actual rates of return to develop its testimony when representing customers during cost of capital proceedings. Cal Advocates' testimony focuses on comparative financial models to determine an appropriate rate of return. Cal Advocates views the rate of return as a regulatory construct that is absolutely necessary for setting rates prospectively, but one that is largely useless for verifying actual financial performance. We disagree with this perspective. We acknowledge that a higher actual rate of return compared to the authorized rate is only one of many possible indicators that forecasted costs have been overestimated. Importantly, Cal Advocates' own Water Branch has recognized the potential for utilities to overestimate costs or to have excessive earnings. As a solution, it believes the use of an *earnings test* can address these potential concerns. Earnings

tests compare a utility's authorized return to the recorded return in order to evaluate a utility's earnings before a rate increase is authorized. An official in the Water Branch told us that a similar process can be applied to energy utilities. Although Cal Advocates' Energy Branch believes that there are significant differences between water and energy ratemaking that limit its ability to implement similar tests, we agree with the Water Branch that this is a significant concern for energy utilities as well. Consequently, Cal Advocates needs to strengthen its processes to provide a better review of utilities' forecasted costs to ensure they are not overstating them.

The CPUC and Cal Advocates Could Improve Their Process for Ensuring That a Utility Has Completed the Work for Which It Submits a Cost Recovery Application

The CPUC and Cal Advocates could strengthen their processes to verify whether a utility has actually completed the activities associated with the costs it requests to recover through its cost recovery application. A utility may incur costs that it did not anticipate when filing its general rate case application. In these instances, the utility files a cost recovery application to seek authorization to increase its rates so that it can recover certain unexpected costs that it incurred. Once the CPUC approves the cost recovery application, the utility typically submits an advice letter to seek authorization to increase its rates.

In this audit, we reviewed utilities' recovered costs related to their wildfire mitigation activities. Recently enacted legislation has caused an increase in these activities. As Table 6 shows, utilities submitted several cost recovery applications for various wildfire mitigation activities.[15] The text box shows examples of the types of wildfire mitigation activities that the three utilities included in these applications.

Although the utilities increased their customers' rates to cover the wildfire mitigation costs that the CPUC approved, they earned only about a 6 percent return on the approved costs as of June 2023. In general, capital investments for wildfire mitigation are subject to the same rate of return as other capital investments—between 7.3 percent and nearly 7.7 percent in 2022. However, state law prohibits large utilities from earning a return on equity on the initial $5 billion in collective wildfire mitigation capital expenses, resulting in an overall lower rate of return on these types of capital investments.

Examples of Wildfire Mitigation Activities That Utilities Included in Their Cost Recovery Applications

- Vegetation Management
- Public Safety Power Shutoffs
- Undergrounding Power Lines
- Installing Covered Power Lines
- Inspection Programs
- Enhanced Situational Awareness
- Enhanced Overhead Inspection
- Fusing Mitigation
- Wildfire Mitigation Training and Development

Source: Cost recovery applications that SDG&E, SCE, and PG&E submitted during fiscal years 2019–20 through 2021–22.

[15] Wildfire mitigation activities are generally specific to electric utilities. We do not present SoCal Gas's wildfire mitigation activities because they are not significant.

Table 6
All Three Major Utilities Filed Cost Recovery Applications for Wildfire Mitigation Activities From Fiscal Years 2019–20 Through 2021–22

	DATE FILED	STATUS	TOTAL AMOUNT REQUESTED *(in millions)*	TOTAL AMOUNT APPROVED *(in millions)*
SDG&E	7/1/2020	Closed	$10	$10
PG&E	2/7/2020	Closed	1,164	447
	9/30/2020	Closed*	1,583	591†
	9/16/2021	Decision Pending	1,468	Decision Pending‡
SCE	11/30/2020	Closed	793	703
	3/15/2021	Closed	1,155	850
	6/3/2022	Decision Pending	426	Decision Pending

Source: CPUC documents related to rate case and wildfire risk mitigation cost recovery applications.

* The commission has issued a final decision for this proceeding; however, a party has requested a rehearing, which could change the outcome.

† This decision authorizes PG&E to recover a total revenue requirement of just more than $1 billion. For purposes of collection through rates, this recovery amount is reduced by roughly $447 million, which was the amount recovered as a result of the earlier interim decision related to the application filed in February 2020.

‡ The commission has issued a proposed decision for this application. As of July 2023, a final decision has not been issued, and this proceeding remains open.

The CPUC has broad authority to develop rules that govern how utilities apply for cost recovery and to compel utilities to provide any information necessary to justify those costs. However, the CPUC does not regularly verify whether a utility has completed the activities that generated the costs it includes in an application. Because utilities have already incurred these costs, they should be able to demonstrate that they completed the associated activities. For example, in July 2020 SDG&E sought to recover $10.4 million for reasons including enhanced wildfire mitigation activities that it conducted in 2019. SDG&E should therefore have had evidence to support that it completed these activities. Verifying that utilities have completed work may not be feasible or cost-effective in every instance; however, given that state law requires the CPUC to deny recovery of costs that it deems unreasonable, the CPUC should develop a process that reduces the risk of utilities' claiming costs for work that they did not complete.

Cal Advocates could also do more to verify the work associated with utilities' cost recovery requests. State law requires Cal Advocates to represent and advocate on behalf of the interests of customers to obtain the lowest possible rates consistent with reliable and safe service levels. According to Cal Advocates, one way that it achieves this goal is by reviewing utilities' cost recovery applications and supporting documentation to ensure that the costs are reasonable and appropriate. Cal Advocates' review is critical because the CPUC relies in part on Cal Advocates' testimony to assess whether a utility's request is reasonable.

Although Cal Advocates was able to demonstrate its analysis of the costs included in the cost recovery applications we selected, that analysis focused on incremental costs and did not verify whether a utility actually completed the related activities. Cal Advocates asserted that it allows its staff to use their discretion in determining whether to request evidence that a utility performed the work it claims. It further noted that it does not

have staff dedicated to conducting field investigations to verify whether a utility has performed the activities associated with the costs. However, its approach concerns us because a utility has an incentive to claim costs for projects that are not completed: the utility can boost its revenue.

Different divisions within the CPUC and other state agencies publish reports that may demonstrate whether a utility has completed the work for which it is requesting to recover costs. For example, the Office of Energy Infrastructure Safety (Energy Safety Office) is required by law to approve or deny utilities' wildfire mitigation plans, and it oversees utilities' compliance with wildfire mitigation requirements.[16] A wildfire mitigation plan describes the risks of a utility's electric lines and equipment causing a wildfire in a utility's service area and specifies the actions that the utility will take to reduce those risks. The Energy Safety Office publishes annual compliance assessments that provide a detailed review of the fire risk mitigation activities that each utility has performed and identify areas of noncompliance. When those reports are available at the time of the utility's cost recovery application, the CPUC and Cal Advocates could use them to verify whether the utility completed certain work. Moreover, in the absence of the reports, they could contact the Energy Safety Office to gain further assurance. Finally, the CPUC and Cal Advocates could require utilities to provide evidence, such as photographs of work, to demonstrate that they completed the activities for which they are claiming costs.

When we asked the CPUC and Cal Advocates about taking these approaches, Cal Advocates explained that it may review a utility's supporting documents and work orders and that it may request additional evidence to determine whether the utility has completed projects. In contrast, the CPUC's Energy Division asserted that it is not responsible for verifying a utility's work. CPUC regulations require utilities to certify that any documents provided to the CPUC as testimony or evidence are correct. Thus, it relies on the utilities' certification that the information it has provided is accurate. However, both the CPUC and Cal Advocates agreed that they could strengthen their processes to gain assurance that utilities are actually performing the work for which they are attempting to recover costs. Without verifying—even for a selection of costs—that utilities have performed the activities in question, the CPUC and Cal Advocates risk allowing utilities to recover costs for activities that they did not complete, which are costs that will in turn be passed on to customers.

Moreover, there is risk that a utility may attempt to include activities in a cost recovery application that are the same as those it already included in a general rate case application, thus passing on the same costs to customers twice. For example, vegetation management and tree trimming requirements existed before the current wildfire mitigation plan requirements went into effect. Some utilities have already included those costs in their most recently approved general rate case applications and use balancing accounts to track those costs. However, vegetation management activities are also part of utilities' wildfire mitigation plans. Further, some utilities

[16] Established July 12, 2019, the Energy Safety Office is a separate office under the Natural Resources Agency that approves or denies utilities' Wildfire Mitigation Plans and is required by law to review each utility's compliance with its approved wildfire mitigation plan.

conduct enhanced vegetation management, which exceeds the previous vegetation management requirements by, for example, increasing the clearance distance between vegetation and power lines from 4 feet to 12 feet. Legislation enacted in 2018 and 2019 added requirements that specify how utilities prepare and follow wildfire mitigation plans and allowed utilities to track the related costs in memorandum accounts, to recover in rates at a later date. As a result, utilities could track vegetation management costs in already established balancing accounts or in these newly created memorandum accounts. Because these activities are similar, clearly distinguishing between the costs that a utility included in its previous general rate case application and those costs that it incurred to meet enhanced requirements is not straightforward.

Moreover, in a report we issued in March 2022, we noted that recent audits of utility expenditures questioned whether the CPUC should allow the three largest utilities to collectively recover about $2.5 billion through rate increases.[17] The utilities recorded that these costs related to wildfire mitigation. However, in June 2020 the CPUC hired a contractor to assess whether any wildfire mitigation costs in 2019 and 2020 mitigation plans duplicated expenditures authorized in previous general rate case proceedings. The audits of PG&E, SCE, and SDG&E questioned whether nearly $2.5 billion in future cost recovery could either duplicate costs that the CPUC had already authorized through a general rate case proceeding or require additional justification and documentation from the utilities to determine whether they duplicated such costs. Although the utilities and the CPUC disagreed with many of the audit results, the contract auditor generally stood by its findings and in multiple instances asserted that utilities should provide additional information or that the CPUC should carefully monitor future claims by the utilities to ensure that these costs are not passed on to customers again in the form of higher rates.[18]

To address these concerns, our 2022 audit report recommended that the CPUC should perform audits of the utilities' wildfire mitigation costs for activities that were part of their previous general rate cases before the CPUC approved the costs' recovery. In addition, we recommended that the CPUC implement sufficient safeguards to ensure the appropriateness of the costs that the utilities pass on to customers. We also recommended that if the utilities request reimbursement for the costs questioned in the contractor audits, the CPUC should require that they provide sufficient quantifiable and detailed analyses to demonstrate that the costs do not duplicate previously authorized costs.

The CPUC has made progress on these recommendations and in March 2023 implemented procedures to address our previous audit findings. It completed an internal study evaluating its safeguards against duplicative cost recovery and determined that its safeguards are adequate if a review of the cost recovery application shows that at least two of four audit criteria have been met. It has

17 *Electrical System Safety: California's Oversight of the Efforts by Investor-Owned Utilities to Mitigate the Risk of Wildfire Needs Improvement*, Report 2021-117, March 2022.

18 The CPUC stated that the contract auditor's findings were incorrect because the contractor used a flawed methodology. Further, the CPUC explained that it ultimately did not identify any double-recovery of the $2.5 billion in costs that the contract auditor questioned.

compiled and updated a list of proceedings to track utilities' requests for wildfire mitigation cost recovery. The CPUC has also assessed the sufficiency of safeguards to ensure that costs are appropriate for the first of the wildfire mitigation proceedings that have completed evidentiary hearings. It believes that the litigation process for each proceeding provides sufficient quantifiable and detailed analyses to substantiate costs and has identified the proceedings that address the previously mentioned audit findings.

Finally, in June 2023 the CPUC completed an audit of SCE's cost recovery application for wildfire mitigation and vegetation management costs for the period of January 1, 2021, through December 31, 2021. The audit found, among other things, that SCE had overstated operations and maintenance expenses for fire risk mitigation, overstated its requested revenue requirement, and sought to recover unsubstantiated capital-related revenue requirements. Such findings can underscore the importance of scrutinizing cost recovery applications closely.

The CPUC Could Better Explain to Customers Why Rates Are Justified and Reasonable

The CPUC lacks an effective process to ensure that utility customers are fully aware of the reasons their rates are increasing. We reviewed the CPUC's general rate case proceedings to determine whether those proceedings clearly articulate the reasons for increases in utility costs. However, we found that the proceedings are designed to litigate utilities' revenue requirements rather than communicate to customers the reasons for rate changes. The CPUC also does not clearly and comprehensively communicate the reasons for rate increases resulting from advice letters that the utilities file between general rate case proceedings. We reviewed rate advisories that the CPUC began publishing on its website in 2020 and found that the explanations it provided for rate increases were often highly technical and unclear. The CPUC has asserted that direct communication with customers is the utilities' responsibility. However, we note the CPUC is the public agency responsible for regulating utilities to ensure that customers have safe, reliable utility services at reasonable rates; and we believe that by developing a more deliberate and effective means of providing information to customers, the CPUC will keep customers informed about the reasons for rate changes and will better articulate why the CPUC believes that the rates it authorizes are fair and reasonable.

The CPUC General Rate Case Proceedings Do Not Effectively Communicate to Customers the Factors Causing Cost Increases

The CPUC is responsible for regulating utilities and for authorizing, through general rate case proceedings, the rates that utilities may charge their customers. The general rate case process is designed for litigating utilities' revenue requirements and rate structures, not for communicating to customers the reasons for changes in costs. During the involved process of a general rate case proceeding, utilities present evidence supporting their requested revenue requirement to cover all costs of providing services, and interveners like Cal Advocates represent utility customers and advocate for the lowest possible rates. Language in these proceedings is highly technical.

It is the Legislature's intent that the CPUC also be accountable for its decisions. Accordingly, the CPUC should clearly explain to the public why rates are increasing, providing the public with greater assurance that the CPUC is faithfully carrying out its responsibility to review and approve utility rate increases. Although the general rate case decision captures the basis for the CPUC's determination that the rates it approves for a utility are just and reasonable, customers cannot use such a decision to readily identify the reasons for increases in a utility's revenue requirement and thus increases in its rates.

General rate case decisions do not always identify whether and by how much the revenue requirement increased from the previous general rate case. For the general rate case proceedings we reviewed, the CPUC appended exhibits to each of its decisions that identified the utility's authorized revenue requirement. For example, in its exhibit for its SDG&E decision covering 2019 through 2021, the CPUC included a table that identified the authorized required revenue amounts for high-level categories such as distribution and administration. In some of its general rate case decisions, it also attached discussions that included information about a utility's previous actual expenses and the increase in amounts that a utility requested. The CPUC provided this sort of additional detail in the discussion part of its SDG&E decision covering 2019 through 2021.

In contrast, the CPUC's decision for SCE covering 2021 through 2023 did not always include such information. For example, although an appended table noted that the CPUC authorized $103 million for customer records and collection expenses, the CPUC did not discuss these expenses in its general rate case decision. In fact, the phrase *customer records and collection expenses* did not appear at all—either in the CPUC's general rate case decision or in the utility's application. Without clear reasons for increases in utilities' requested amounts, customers who are interested may not be able to understand the resulting rate increases or the rationale for those increases.

Moreover, the general rate case decisions do not always include the reasons for increases in requested amounts. According to the CPUC, if utilities' requests are sufficiently well-documented in its exhibits and if there are no protests of elements of the cost component, the presiding judge may not pursue further inquiries through cross-examination. In the general rate case decisions we reviewed, we found that the CPUC provided only limited explanations for the factors causing the increases in costs. For example, in the discussion of SDG&E's distribution costs covering 2019 through 2021, the CPUC's decision identified 26 cost categories that contributed to total distribution costs. The CPUC also included a high-level rationale for the increase in requested amounts that it approved. In one example, the CPUC approved SDG&E's request for additional linemen—an increase meant to address outage response times and reliability concerns—and for a customer communications safety program meant to reduce safety risk levels, but it did not in either instance fully describe the activities under discussion or quantify the cost of those activities.

In fact, to fully understand the reasons for the rate increases for the utilities we reviewed, we had to contact each utility and request detailed documentation that identified the cost categories that increased, the amounts by which those categories increased, and the reasons the utilities provided for increased costs. For example, we traced SDG&E's authorized electricity distribution costs of $155 million for 2019 from CPUC's decision back to SDG&E's work papers supporting the utility's application so that we could

determine which cost categories increased and the rationale that the utility provided to the CPUC for the higher amounts. Our review eventually identified the bases for increases in the 26 cost categories from the previous general rate case proceedings. For example, we learned that costs for electric regional operations, which provide coverage for all of SDG&E's electricity distribution system through its service territory, increased because of new activities that the utility proposed to undertake. Notably, SDG&E proposed to hire 20 linemen at a labor rate of $55 per hour to improve outage response times and system reliability and to spend $6 million to establish an outreach and education campaign geared toward *wire-down* awareness and other electric safety issues, like wire contact with cars, trees, or ladders. However, a customer would neither have access to this information nor likely the willingness to review such a level of detailed documentation. By summarizing these types of factors, possibly as part of its rate change advisories that we describe in the next section, the CPUC could explain publicly to ratepayers why a utility's rates should increase.

The CPUC Could Improve Its Communication to Customers Regarding the Reasons Rates Are Changing

Utilities submit advice letters to the CPUC to implement a number of different types of changes to their rates and operations. Although utilities file hundreds of advice letters each year, the CPUC explained that each utility typically files only between three to five advice letters annually that affect its rates. The CPUC implements most of these rate changes through a consolidated advice letter in December. For example, from December 2021 through December 2022, SDG&E filed three advice letters that affected electricity rates—an advice letter to implement new rates effective in January 2022, one effective in June 2022 that slightly decreased rates, and an end-of-year consolidated advice letter for rates effective in January 2023.

The utilities include highly technical information in each advice letter, describing the letter's purpose, providing background information, and including detailed tariff schedules. We note that these letters do not effectively and clearly communicate to customers the reasons that rates are changing. The advice letters that we reviewed regarding rate changes from January 2022 through January 2023 did not consistently include clear explanations of the rate changes. For example, the consolidated advice letter that SDG&E filed in December 2022 included a table, shown in Figure 12, that summarizes the current rate for each customer class, including the portion related to the pass-through cost of electricity, the rates to be implemented, the rate change in dollars, and the resulting percent increase. Although this table provides useful information regarding the amounts that rates will change, it does not explain to a customer why the rates are changing.

Figure 12
SDG&E Included In Its Advice Letters a Table Showing Current and Proposed Rates by Customer Class

SAN DIEGO GAS ELECTRIC COMPANY - ELECTRIC DEPARTMENT
Consolidating Filing

SDG&E Advice Letter AL 4129-E
Class Average Rates

	RATES EFFECTIVE 6/1/2022 AL 4004-E			RATES TO BE IMPLEMENTED PROPOSED 1/1/2023				
	Current Total UDC[1] Rate (¢/kWh)	Current Avg. Commodity (¢/kWh)	Current Total Rate (¢/kWh)	Total UDC Rate (¢/kWh)	Avg. Commodity (¢/kWh)	Total Rate (¢/kWh)	Total Rate Change (¢/kWh)	Total Rate Change (%)
Residential[2]	19.828	14.206	34.034	20.710	19.665	19.665	40.375	18.63%
Small Commercial	19.782	12.095	31.877	22.807	17.417	17.417	40.224	26.19%
Medium and Large Commercial and Industrial	14.560	13.912	28.472	17.165	20.388	20.388	37.553	31.89%
Agriculture	12.237	10.472	22.709	14.064	14.550	14.550	28.614	26.00%
Lighting	19.519	9.316	28.835	21.784	12.860	12.860	34.644	20.15%
System Total	16.849	13.661	30.510	18.999	19.472	19.472	38.471	26.09%

Class Average Rates
Excluding California Climate Rate

	RATES EFFECTIVE 6/1/2022 AL 4004-E			RATES TO BE IMPLEMENTED PROPOSED 1/1/2023				
	Current Total UDC[3] Rate (¢/kWh)	Current Avg. Commodity (¢/kWh)	Current Total Rate (¢/kWh)	Total UDC Rate (¢/kWh)	Avg. Commodity (¢/kWh)	Total Rate (¢/kWh)	Total Rate Change (¢/kWh)	Total Rate Change (%)
Residential[3]	23.051	14.206	37.257	23.519	19.665	43.184	5.927	15.91%
System Total	17.970	13.661	31.631	20.068	19.472	39.540	7.909	25.00%

Wildfire Fund NBC rate and DWR Bond Charge Credit are reflected in the Average UDC rate.
[1] Utility Distribution Company
[2] UDC includes residential California Climate Credit which is received semi-annually
[3] UDC excludes residential California Climate Credit which is received semi-annually

Source: SDG&E's consolidated advice letter filing to implement electricity rates effective January 1, 2023.

As another example of how advice letters are not effective in communicating to customers the reasons for rate changes, we note that none of the advice letters we reviewed consistently explained how the proposed changes in the utilities' revenue requirements would affect their rates. For example, in January 2023 SDG&E's advice letter reported a $144 million increase, or an increase of 3.4 percent, to its $4.2 billion revenue requirement. However, the letter did not adequately identify the reasons for the increase and did not explain why that increase would result in an increase of 8 cents, or 25 percent, to its system rate. Similarly, for its rates effective in January 2023, SCE requested a $1.5 billion increase, or an increase of 10 percent, to its $15.2 billion revenue requirement. However, SCE did not explain why this increase would result in an increase of 1.5 cents, or 6 percent, to its rates.

Further, although the utilities included some information in the advice letters describing the changes in their revenue requirements, none of the letters we reviewed fully explained the reasons for the changes. For example, in January 2023, SDG&E noted a $119 million increase in its revenue requirement to recover increases in transmission costs. However, it did not explain why its transmission costs had increased.

After receiving and approving the consolidated advice letters, the CPUC could have published a summary, or rate advisory, specifically for customers' reference on the reasons their rates are changing. However, it has only developed such advisories for internal use. When we asked the CPUC why it has not developed such rate advisories for customers to easily understand changes in their rates, it explained that it is the utilities' responsibility to communicate directly with customers. However, we assert again that the CPUC is the public agency responsible for reviewing and approving rate increases that greatly impact the customers of the utilities it regulates and that it should take steps to clearly communicate to them the reasons for rate changes, to better demonstrate that the rates it authorizes are fair and reasonable. We reviewed a selection of rate advisories that the CPUC created for internal use, which it publishes on its website, and found them helpful but in need of some improvement.

The CPUC did not design these advisories for customers' use, and we found that although the rate advisories include useful information, such as the estimated average electricity bill increase resulting from the advice letter, they also include highly technical terminology that a general customer may not understand or appreciate. For example, the rate advisories may reference the changes in rates resulting from advice letters regarding utility accounts, such as the Tax Accounting Memorandum Account or Transmission Access Charge Balance Account Adjustment. The advisories also do not clearly and fully explain the reasons for the rate changes. For example, the CPUC issued a rate advisory in November 2021 for SDG&E that stated that one reason for the increase was the CPUC's approval of the utility's general rate case, which allocated SDG&E's forecasted costs among customer classes. However, this is an explanation of how the rate increased, not why it increased, and it leaves customers unable to glean an understanding of why their rates had increased and the reasonableness of those increases.

By not providing details to customers about the significant costs driving rate changes and not offering a brief and clear explanation of why those costs are necessary, the CPUC is missing an opportunity to enhance transparency regarding electricity and

natural gas rates and better demonstrate to the public that the rates it authorizes are fair and reasonable. Because only a few advice letters significantly affect rates each year, we believe that the CPUC could better serve customers by publishing on its website—and requiring utilities to publish on their websites—a summary of changes to the rates and the key reasons for the changes. The CPUC could do this every time it authorizes a rate change through an advice letter. Explaining to the public why a utility's rates are increasing—and the underlying cost drivers that the CPUC believes are reasonable—would enhance the public's understanding, promote greater transparency, and further the CPUC's public mission.

Chapter 3

CAL ADVOCATES HAS OPPORTUNITIES TO IMPROVE THE REVIEWS IT PERFORMS

Key Points

- Cal Advocates has not demonstrated that it is reviewing a suitable number of the balancing accounts through which utilities track certain revenues and costs that may result in rate changes. Further, when we examined a selection of Cal Advocates' reviews, we identified instances in which it did not document key steps, such as supervisor reviews of staff work.

- Cal Advocates' review of utilities' general rate case applications and advice letters is important in ensuring that customers pay the lowest rates for services. However, Cal Advocates lacks documented policies for determining which parts of general rate case applications to protest and how to conduct those protests. It also lacks policies to ensure that it conducts documented reviews of all advice letters.

Cal Advocates Could Increase the Effectiveness of Its Balancing Account Reviews

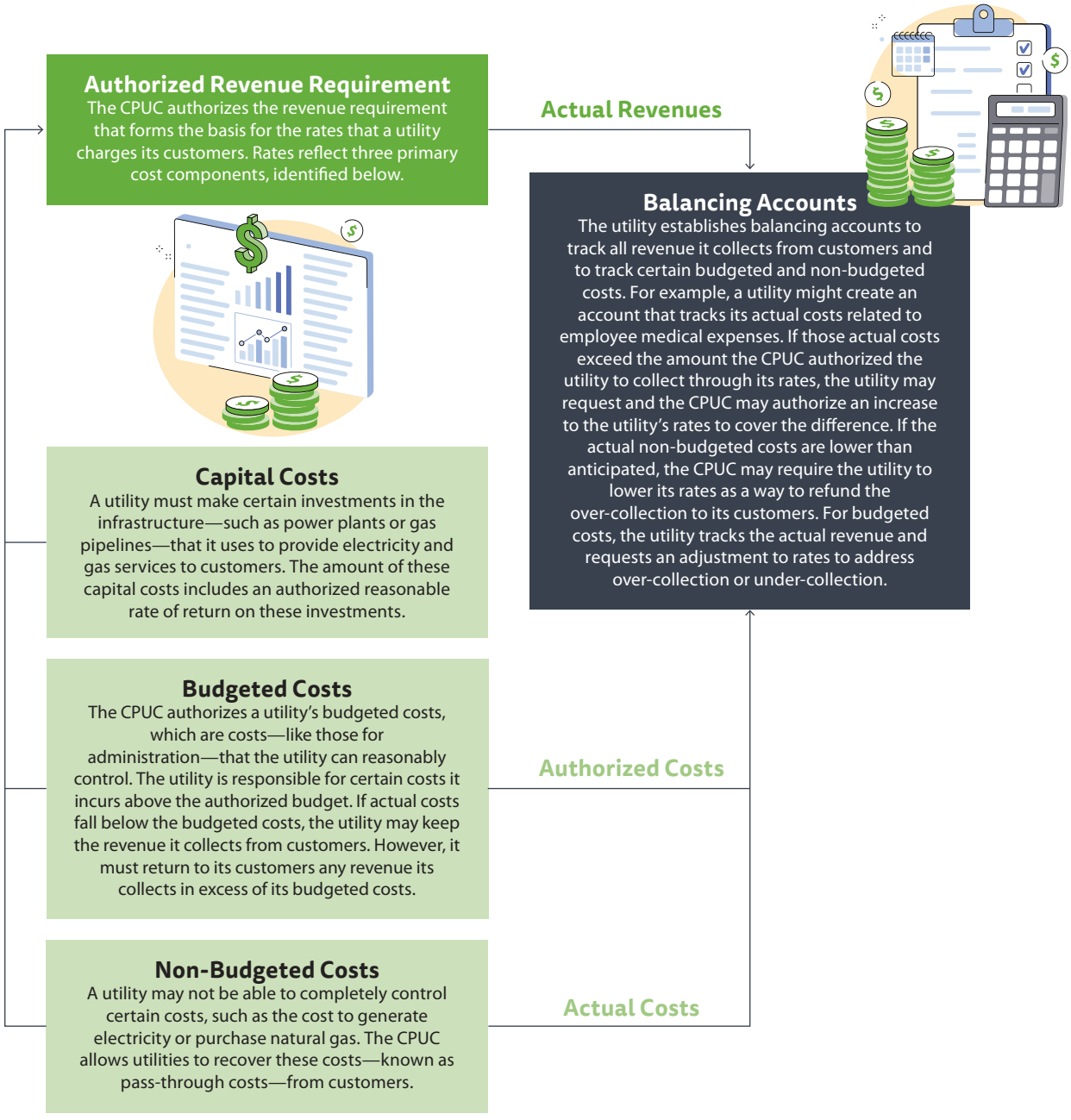
Utilities record billions of dollars—more than a third of their authorized revenue—in balancing accounts. The utilities use these accounts to track whether their actual costs and revenue agree with the amounts forecasted in their authorized general rate case decisions. If an account shows that a utility has under- or overcollected revenue, the utility will eventually either collect the balance through rate increases or offset the balance through rate reductions.

Cal Advocates reviews balancing accounts, which the CPUC requires utilities to use to track certain authorized revenues and costs, to help protect customers from excess rate increases. During its review, Cal Advocates assesses utilities' recordkeeping accuracy and their compliance with CPUC directives. However, for fiscal year 2021–22, Cal Advocates reviewed 42, or 13 percent, of the more than 300 balancing accounts that the four utilities we reviewed had established. Cal Advocates' selection covered less than 20 percent of the total balances—$2.8 billion of $15.5 billion across all accounts that year—and did not include some accounts with tens of millions of dollars in balances that may lead to future rate adjustments. We do not expect Cal Advocates to review all balancing accounts, but we believe that Cal Advocates can do more to ensure that it reviews balancing accounts that can have the most impact on customer rates. Moreover, when we assessed a selection of accounts that Cal Advocates reviewed in the past three fiscal years, we found that it did not always document its staff's findings and conclusions or consistently provide evidence that supervisors had reviewed staff's work. Without such documentation, Cal Advocates risks errors or omissions in its reviews that could lead to its not identifying unjustified rate increases.

Balancing Accounts Are a Key Mechanism for Calculating Utility Rate Adjustments

Because the rates that the CPUC authorizes are based on a utility's forecasted costs and its estimated customer consumption, both the utility and the CPUC have an interest in determining the utility's actual costs and revenue related to certain cost categories. Figure 13

Figure 13
Utilities Use Balancing Accounts to Ensure That They Do Not Collect More or Less Than the Authorized Revenue From Customers


Authorized Revenue Requirement
The CPUC authorizes the revenue requirement that forms the basis for the rates that a utility charges its customers. Rates reflect three primary cost components, identified below.
Actual Revenues
Balancing Accounts
The utility establishes balancing accounts to track all revenue it collects from customers and to track certain budgeted and non-budgeted costs. For example, a utility might create an account that tracks its actual costs related to employee medical expenses. If those actual costs exceed the amount the CPUC authorized the utility to collect through its rates, the utility may request and the CPUC may authorize an increase to the utility's rates to cover the difference. If the actual non-budgeted costs are lower than anticipated, the CPUC may require the utility to lower its rates as a way to refund the over-collection to its customers. For budgeted costs, the utility tracks the actual revenue and requests an adjustment to rates to address over-collection or under-collection.
Capital Costs
A utility must make certain investments in the infrastructure—such as power plants or gas pipelines—that it uses to provide electricity and gas services to customers. The amount of these capital costs includes an authorized reasonable rate of return on these investments.
Budgeted Costs
The CPUC authorizes a utility's budgeted costs, which are costs—like those for administration—that the utility can reasonably control. The utility is responsible for certain costs it incurs above the authorized budget. If actual costs fall below the budgeted costs, the utility may keep the revenue it collects from customers. However, it must return to its customers any revenue its collects in excess of its budgeted costs.
Authorized Costs
Non-Budgeted Costs
A utility may not be able to completely control certain costs, such as the cost to generate electricity or purchase natural gas. The CPUC allows utilities to recover these costs—known as pass-through costs—from customers.
Actual Costs

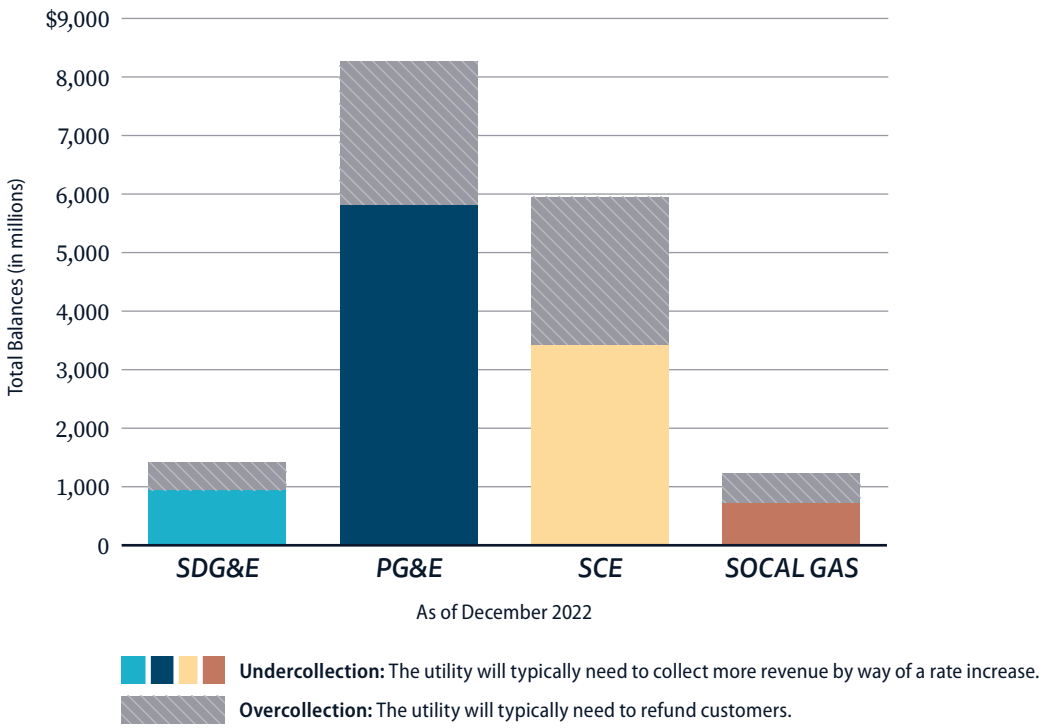
Source: Utility balancing account reports to the CPUC, balancing account review documentation from Cal Advocates, balancing account statements, and the CPUC's 2022 Senate Bill 695 report.

Note: The CPUC has approved various rules for different accounts. Not included in this figure are entries for actual revenues that a utility collects or transfers from other accounts, which the CPUC allows for some balancing accounts, and monthly interest which utilities may typically collect in the accounts.

illustrates how balancing accounts track utilities' revenue and actual costs related to these categories. For example, SDG&E has a balancing account that tracks, among other items, the difference between the actual natural gas-related costs of its low-income discount program for natural gas and electricity customers and the actual revenue it collected from customers. In December 2021, SDG&E recorded in this account that it had collected about $4.7 million less than the program's expenses, indicating that SDG&E would need to eventually increase customers' rates to make up the difference. Balancing account balances can vary over time as utilities adjust their rates and as their revenue and costs change; by December 2022, SDG&E recorded that it had a $2.9 million overcollection in the same account, indicating it would need to refund customers by decreasing its rates.

As of December 2022, the four major electric and gas utilities maintained a total of more than 300 balancing accounts, or between about 40 and 105 such accounts per utility. As of that date, the four major utilities had more than $16.9 billion in cumulative balances across all balancing accounts: $10.9 billion in undercollections and $6 billion in overcollections. Each utility had more than $1 billion in total balances, including both under- and overcollections, as Figure 14 illustrates. Both types of balances demonstrate a deviation from utilities' authorized levels of spending, sales, and revenue collection compared to actual costs and revenues.

Figure 14
Each Major Utility Is Carrying More Than $1 Billion in Its Balancing Accounts



Source: Utilities' 2022 annual balancing account reports to the CPUC.

Note: Bars total both undercollected account balances and overcollected balances to show the total magnitude of balances across all electricity and natural gas balancing accounts for each utility.

Entities That Monitor Utilities' Balancing Accounts

- **The CPUC's Energy Division** is authorized under CPUC requirements to review and make determinations on certain advice letters, including a type in which utilities request to recover or refund balancing account balances through rate changes. If the Energy Division chooses, it may request balancing account data from utilities.
- **The CPUC's Utility Audits Branch** receives balancing account data from utilities annually and uses that data to create an internal risk assessment. Guided by this risk assessment, the Utility Audits Branch conducts formal audits of a selection of balancing accounts that it identifies as being at risk.
- **Cal Advocates** reviews a selection of balancing accounts to support its testimony during specific formal proceedings. Its review procedures include analyzing supporting information such as invoices and accounting records, reviewing relevant documents such as CPUC decisions, and preparing an audit report on the results of the review that describes any issues or needed adjustments it identifies.

Source: State law, interviews with CPUC and Cal Advocates staff, review of the CPUC's assessments of utility-submitted balancing account data and CPUC audits, and review of Cal Advocates' testimony and procedures for reviewing balancing accounts.

A balancing account that carries a high balance—either an undercollection or an overcollection of revenue from customers—generally predicts a rate change in the near future. The CPUC may allow or direct the utility to recover or refund these costs to customers at different times. Any utility's request for recovery or refund of an account must comply with CPUC requirements and decisions, which govern when utilities may file such an advice letter for each account.

Review of balancing account balances and records to ensure they are accurate and compliant with CPUC rules is an important step to ensuring that customers are protected from erroneous or inappropriate rate increases. We describe in the text box the roles of the CPUC and Cal Advocates in monitoring balancing accounts. The Joint Legislative Audit Committee specifically directed us to review Cal Advocates' role in reviewing balancing accounts and to determine whether it has created and follows a systematic process that ensures it reviews all balancing accounts that may have the most impact on customers.

Cal Advocates Lacks a Process to Ensure That It Reviews Large Balancing Accounts That Can Significantly Affect the Rates Customers Pay

Multiple balancing accounts that we reviewed had undercollected balances of more than $100 million that utilities will need to recover by increasing their rates in the future. Given the impact that these balancing accounts might have on customers' rates, we expected Cal Advocates to take measures to ensure their accuracy. However, Cal Advocates focuses its review on only a limited number of balancing accounts, and it focuses on accounts that relate to specific CPUC proceedings. For example, it performs its electricity balancing account reviews during an annual examination of the major utilities' costs to purchase energy.[19] Cal Advocates explained that its work focuses on supporting its litigation of utility requests to put new costs into rates, not on reviewing compliance related to spending that the CPUC has already authorized.

As a result, Cal Advocates reviews only a small proportion of both the total number of balancing accounts and the total balances across all accounts. As Table 7 shows, during fiscal year 2021–22, Cal Advocates reviewed only 13 percent of the total

[19] The Energy Resource Recovery Account Compliance proceeding is an annual review that the CPUC performs of each utility's purchases of fuel for electricity generation and its administration of related contracts. Cal Advocates typically participates in the proceeding by submitting a report on its assessment of a utility's contract management as well as the balancing account reviews we discuss in this section.

number of balancing accounts for the four utilities. Similarly, the information Cal Advocates provided to us indicated that during fiscal years 2019–20 through 2021–22, Cal Advocates annually reviewed between a total of 35 and 42 electricity balancing accounts for the three major electric utilities, or about 6 to 33 percent of each electric utility's balancing accounts. Cal Advocates reported performing 116 electric utility balancing account reviews in total during this period, although many reviews covered the same accounts each year because those accounts were associated with the annual proceeding to evaluate energy costs.

Table 7
In Fiscal Year 2021–22, Cal Advocates Reviewed Only a Limited Selection of Balancing Accounts

	TOTAL NUMBER OF ACCOUNTS	TOTAL BALANCES *(in millions)*		TOTAL NUMBER REVIEWED	TOTAL BALANCES REVIEWED *(in millions)*	PERCENTAGE OF ACCOUNTS REVIEWED	PERCENTAGE OF BALANCES REVIEWED
TOTALS	316	$15,546	Undercollected: $10,692 Overcollected: $4,854	42	$2,797	13%	18%
TOTAL ELECTRICITY	196	13,290	Undercollected: $9,382 Overcollected: $3,909	39	2,777	20%	21%
SDG&E	51	905	Undercollected: $576 Overcollected: $328	11	145	22%	16%
PG&E	73	8,223	Undercollected: $6,612 Overcollected: $1,611	7	330	10%	4%
*SCE**	72	4,163	Undercollected: $2,193 Overcollected: $1,970	21	2,302	29%	55%
TOTAL GAS	120	2,255	Undercollected: $1,310 Overcollected: $945	3	20	3%	1%
SDG&E	32	258	Undercollected: $185 Overcollected: $73	0	–	–	–
PG&E	47	904	Undercollected: $557 Overcollected: $347	2	20	4%	2%
*SOCAL GAS**	41	1,093	Undercollected: $568 Overcollected: $525	1	Less than $1 million	2%	Less than 1%

Source: Cal Advocates' prepared testimony, interviews with Cal Advocates' staff, and balancing account reports that the utilities submitted to the CPUC.

* For SCE and SoCal Gas, we reviewed Cal Advocates' reviews of electricity and gas balancing accounts, respectively.

Cal Advocates explained that it reviewed these accounts because the electric utilities chose or were directed by the CPUC to include in annual proceedings the requests for rate changes related to the accounts. Although inclusion in a formal proceeding may be a relevant factor for identifying accounts that could affect customers, we are concerned that using this as the only factor is to some extent allowing utilities to dictate which accounts Cal Advocates will review. Instead, we believe that

Cal Advocates should develop a risk-based approach that considers the size of reported under- and overcollections as well as the inherent risks associated with the types of costs being tracked.

Additionally, Cal Advocates noted that in the same three fiscal years, it reviewed only three of a total of approximately 120 balancing accounts for the largest natural gas utilities. It explained that it reviewed two balancing accounts for PG&E and one balancing account for SoCal Gas and SDG&E, which share gas purchasing functions because they are subsidiaries of the same parent company. Cal Advocates explained that it reviewed the accounts because the natural gas utilities made requests related to those accounts during CPUC proceedings regarding natural gas purchases.[20] These accounts had total balances of about $20 million in combined under- and overcollections as of December 2021, or less than 1 percent of the cumulative $2.3 billion in total balances across all natural gas-related balancing accounts for SoCal Gas, PG&E, and SDG&E.

Cal Advocates asserts that when combined with the CPUC's efforts, its review of energy balancing accounts is sufficient to capture major risks to customers; however, we disagree. The energy balancing accounts that it did not review during the three-year period we evaluated included many of those with the highest balances. For example, in fiscal year 2021–22, Cal Advocates did not review multiple accounts with more than $30 million in undercollected balances each. Cal Advocates acknowledged that it has only one staff member, a financial examiner, to analyze natural gas accounts but stated that it would not find value in reviewing every account even with additional staffing because its focus is to determine the reasonableness of utilities' forecasted costs, operational and capital needs, and cost recovery requests. In our view, Cal Advocates' primary responsibility is to protect customers from unjustified rate increases. Therefore, dedicating some effort to reviewing those balancing accounts with significant undercollected balances is prudent and helps to ensure that reported costs are not overstated and do not lead to improper rate increases.

Cal Advocates further asserted that state law more directly requires the CPUC to oversee utilities' balancing accounts, specifically referring us to the CPUC's audits, which we describe previously.[21] However, we do not consider the CPUC's work a complete substitute for Cal Advocate's oversight. In fact, Cal Advocates explained to us that it generally does not rely on the CPUC's audits for its own analyses because it has authority to directly compel utilities to provide records if it so chooses. Although Cal Advocates explained that state law does not specifically task it with reviewing balancing accounts, the law and the CPUC rules that govern parties to proceedings give Cal Advocates broad authority to protect customers, compel utilities to disclose information, and devise a budget—with approval from the Department of Finance—to accomplish its goals.

[20] In these proceedings, the CPUC reviews the utilities' natural gas purchasing costs compared to indexes and offers a reward to shareholders if the utility achieves discounts for its customers. We discuss this incentive in more detail in Chapter 1.

[21] State law requires the CPUC to periodically review or audit balancing accounts using a risk-based approach but allows it to forgo the review or audit if an independent auditor has performed a review or an audit in the preceding five years.

Further, the CPUC also does not audit every large balancing account every year, nor do we expect it to do so. In our 2014 audit report regarding the CPUC's monitoring of balancing accounts, we recommended that it adopt a risk-based approach to select a sufficient number of accounts to review.[22] The Legislature has since made this risk-based approach a requirement, and the CPUC now performs such audits after identifying accounts according to a metric that it explained is a confidential risk rating. The CPUC generally audits accounts for one utility at a time. Consequently, of the nine balancing accounts across the four utilities we selected, we found that the CPUC had performed an audit of only two in the three fiscal years prior to fiscal year 2022–23.[23] These audits covered only $12 million, or 2 percent, of the $612 million in total balances in our selection.

Moreover, Cal Advocates and the CPUC do not directly coordinate when planning their reviews to ensure a wide selection of accounts and to avoid duplicating work. Cal Advocates does not believe that there is a risk of duplication since the focus of its review is different from that of the CPUC's reviews. Similarly, the CPUC Utility Audits Branch explained that it might communicate its risk determinations to Cal Advocates but that it does not view duplication of work as a significant risk because the CPUC understands Cal Advocates' reviews to be narrower than the CPUC's audits. However, we note that the existence of periodic CPUC audits of balancing accounts does not mitigate the risk that Cal Advocates is missing opportunities to identify instances in which utilities may be inaccurately tracking revenue or costs.

We believe that Cal Advocates should consider how it might use its authority and resources to identify and examine the balancing accounts that might significantly affect customers. When we shared our concerns, Cal Advocates management noted that they did not believe it would be an effective use of limited staffing to increase work related to reviewing costs that the CPUC has already authorized, such as those tracked in balancing accounts. Cal Advocates instead preferred to focus its advocacy efforts on new utility requests and on helping the CPUC come to decisions authorizing reasonable rates. However, the significant balances in balancing accounts that we identified represent risks of future rate increases to customers. Accordingly, we expect Cal Advocates to demonstrate that it has fully assessed the risks related to balancing accounts so that it can either justify its current review efforts or support requesting additional staff.

22 *California Public Utilities Commission: Improved Monitoring of Balancing Accounts Would Better Ensure that Utility Rates Are Fair And Reasonable*, Report 2013-109, March 2014.

23 The audit was published in April 2021 and examined SoCal Gas's balancing accounts administered and reported for the audit period January 1, 2018, through December 31, 2018. The audit included a review of two of the accounts we selected. In summary, the CPUC found that transactions recorded in SoCal Gas's balancing accounts were allowable and supportable, but it found an internal control weakness related to inconsistent recording and reporting of current or prior-period interest adjustments.

Cal Advocates Does Not Always Adequately Document and Retain Its Reviews of Balancing Accounts

Cal Advocates has documented portions of its reviews but has historically been inconsistent in creating policies or procedures that specify all the steps of the review process. It has procedures requiring its staff to assess a balancing account's compliance with the pertinent documents and CPUC decisions that describe and govern it, to interview utility staff, and to verify balances by reviewing underlying accounting records. During fiscal years 2019–20 through 2021–22, Cal Advocates completed reviews of six of nine balancing accounts that we identified for our selection. For all six accounts reviewed, Cal Advocates maintained documents showing that it initiated a review and requested evidence to help it gain assurance of the reasonableness of balancing account amounts. However, for two of those six, Cal Advocates did not document that a supervisor had reviewed the analyst's work; it did not have a process for documenting such a review until 2022. Moreover, it was not clear from Cal Advocates' documentation whether staff performed a specific step to examine relevant criteria and background information for the account, including CPUC decisions, rules, and tariffs, as well as relevant prior Cal Advocates reports. Our findings are similar to those in our 2014 report, in which we determined that Cal Advocates typically lacked documentation showing the procedures that staff performed and the supervisor's approval of the reviews.

Cal Advocates explained that one of the reasons we did not identify many natural gas balancing account reviews was that its staff perform other financial examinations—which could include balancing account reviews—during general rate case proceedings. However, when we requested documentation of a review from the 2019 SDG&E general rate case proceeding, Cal Advocates explained that it did not have documentation of any of the reviews from that proceeding because the assigned analyst departed from his position before their completion.

Documentation of staff's analyses and conclusions and of supervisory reviews are essential best practices. Cal Advocates' lack of documentation prevents us from determining whether it gained full assurance of the accuracy and compliance of the balancing accounts it reviewed and whether it appropriately identified, verified, and reported on any significant issues. Without this documentation, Cal Advocates increases the risk of erroneous or incomplete conclusions in its reviews, and it limits its ability to monitor the quality of its work.

Cal Advocates Lacks Clearly Defined Policies for Reviewing and Protesting General Rate Case Applications and Advice Letters

Cal Advocates does not have documented policies that provide staff with formal criteria for reviewing and filing protests on general rate case applications. We expected it to have policies that clearly explained how it would conduct and present its analysis during the general rate case proceedings. Both state law and best practices require agencies to develop and maintain effective policies to guide their actions; to be effective, agencies should clearly define those policies. However, we found that Cal Advocates relies largely on institutional knowledge rather than

documented policies for determining which parts of general rate case applications to protest and how to conduct those protests. We are concerned that this lack of formal written policies limits Cal Advocates' ability to mitigate certain risks, such as loss of institutional knowledge resulting from retirements, and might prevent it from consistently advocating for the lowest rates in every general rate case proceeding.

Cal Advocates' review is a critical step in the ratesetting process. For each general rate case application we reviewed, Cal Advocates analyzed the application and advocated for lower rates. As Table 8 shows, the CPUC's decisions aligned more closely to Cal Advocates' recommendations than to the amounts that the utilities requested. Cal Advocates noted that the vast majority of utility applications contain unique information and that it sometimes identifies issues only after it performs the analysis for the protest. It explained that it consequently must rely on the professional judgement of its staff for litigating each proceeding, but that its supervisors—through their reviews of the various work products created throughout a proceeding—provide ongoing management oversight of staff decisions and actions. However, we believe that an effective set of policies would provide the flexibility to address the specific issues in each proceeding while also providing a framework for staff and supervisors to ensure consistent work quality and the transfer of institutional knowledge.

Table 8
The CPUC's Decisions Have Aligned Closely With Cal Advocates' Recommendations Related to Utilities' Revenue Requirements

GENERAL RATE CASE APPLICATION	REQUESTED REVENUE REQUIREMENT *(in millions)*	CAL ADVOCATES' RECOMMENDATION	CPUC DECISION
SDG&E *(Rates effective 2019)*			
Electric	$1,766	$1,530	$1,590
Gas	433	389	400
PG&E *(Rates effective 2020)*			
Combined electric and gas	9,576	9,021	9,102
SCE *(Rates effective 2021)*			
Electric	7,601	6,937	6,899
SOCAL GAS *(Rates effective 2021)*			
Gas	2,990	2,695	2,770

Source: CPUC general rate case filings.

Further, we note that Cal Advocates could better demonstrate that it reviews advice letters to determine whether a protest is warranted. CPUC requirements provide specific criteria under which an entity such as Cal Advocates may protest an advice letter. Allowable grounds for a protest include that the reimbursement the utility is requesting is unreasonable, that the reimbursement would violate statute or CPUC order, or that it requires consideration in a formal hearing. However, instead

of having in place formal policies for consistently performing and documenting whether advice letters meet any of these criteria, Cal Advocates uses an informal process that it communicates to staff through its training materials and a brief summary document. As part of this process, staff notify management when the contents of the advice letter warrant a protest. Although Cal Advocates also trains staff to communicate with managers when they believe a protest is not warranted, its training and process documents do not require staff to document their rationale for deciding not to protest an advice letter.

When we reviewed 12 advice letters, we expected to find for each letter either a protest based on one or more of the allowed grounds or documentation explaining why Cal Advocates chose not to protest it. However, Cal Advocates did not consistently document and explain its rationale for choosing not to protest. Cal Advocates protested three of the 12 letters and provided documentation explaining its rationale for not protesting another four. The documentation that Cal Advocates provided generally included a memo or an internal email documenting background information, such as the specific CPUC decision involved in the advice letter it reviewed and why Cal Advocates staff determined that the request in the advice letter was reasonable. For example, Cal Advocates staff drafted a memo explaining that an SDG&E request to recover 2022 and 2023 revenue requirements for one of its programs would normally be approved in the general rate case. Staff noted that a CPUC decision had changed SDG&E's next scheduled general rate case proceeding to start in 2024 and that it was reasonable to allow SDG&E to recover the 2022 and 2023 program costs sooner, instead of waiting. We found such analysis appropriate for the purposes of quickly making a decision to decide whether to protest.

However, Cal Advocates could not provide documentation explaining its rationale for choosing not to protest the remaining five advice letters and thus cannot justify its decisions. In some of the five instances, Cal Advocates was able to provide limited evidence, such as emails, to support that staff were aware of the advice letter or planned to meet about it soon after they received it. However, it could provide only an attestation about staff actions rather than documentation of its conclusions. Further, in one case, its explanation was inadequate. In this advice letter, PG&E set forth the proposed prices, terms, and conditions for a pricing program for commercial, industrial, and agriculture customers. The purpose of this letter—a Tier 2 advice letter indicating a request of sufficient impact that it required CPUC staff approval to become effective—was to implement the CPUC policy goal related to reducing demand for energy by increasing nonresidential electricity prices during an evening peak usage period. Cal Advocates explained to us that it does not typically protest requests that do not affect rates for residential or small commercial customers; state law requires it to primarily consider these customer groups for issues related to rates. However, the law does not require Cal Advocates to focus exclusively on these groups; Cal Advocates should have evaluated whether a protest was warranted in this instance.

For another advice letter, which related to a $2.5 million pilot program that the commissioners had authorized, Cal Advocates provided information showing that it planned to hold meetings about the request, but it did not provide any evidence that it actually held meetings. Further, it did not provide documentation explaining

why it ultimately declined to protest the request. For the other three advice letters that Cal Advocates did not protest—two related to monthly natural gas price changes and a consolidated annual natural gas rate update letter—Cal Advocates indicated that it did not keep review documentation of the letters and that it did not typically do so for monthly compliance letters. Although it is reasonable that Cal Advocates would not protest many of the utilities' simpler recurring requests, we still expected to see evidence that Cal Advocates had reviewed the letters for reasonableness and consistency with statute and CPUC decisions. This is especially true of the monthly gas price letters, which—as we illustrate in Chapter 1—can account for significant month-to-month changes in natural gas rates. Cal Advocates asserted that it is unlikely to miss any opportunities to protest because managers hold meetings every two weeks to discuss all incoming advice letters, but it agreed that it could improve documentation of its review.

For those advice letters it chose to protest, Cal Advocates appropriately documented its analyses and provided adequate rationale for the protests. For example, SDG&E filed an advice letter in September 2020 that included a request to initiate a new $1.5 million pilot program to incentivize additional commercial and industrial customers to reduce energy use during high-demand periods. Cal Advocates filed a protest in which it concluded that the requested changes were inappropriate for the advice letter process—that the changes required a commissioner vote instead because of the requested changes' potential impact on rates—and that neither the CPUC nor state law had previously authorized the requested changes. SDG&E ultimately withdrew the letter.

Cal Advocates' advocacy efforts in the general rate case proceeding and advice letter process have the potential to help secure lower rates for customers. When Cal Advocates does challenge rate increases during general rate cases, its recommendations appear to have influenced the CPUC to approve lower revenue requirements than those the utilities had proposed. Similarly, in the past three fiscal years, the CPUC's Energy Division reported approving about 87 percent of the advice letters that were protested—412 out of 471—in contrast to the 98 percent approval rate for the advice letters that were not protested. It is important that Cal Advocates strengthen its procedures that support its analyses of advice letters so that it may demonstrate that it is fully and effectively using protests to inform CPUC's decisions. This is especially true in the current period of significant rate increases.

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Other Areas Reviewed

State law requires the CPUC to report annually to the Legislature on its recommendations for actions that can be undertaken during the succeeding year to limit utility cost and rate increases. During our audit, we became aware of some of the changes that the Legislature and the CPUC have implemented to address rising utility rates. We reviewed these changes and their expected impact on rates. We also reviewed the CPUC's current efforts to address rising utility rates.

Recent Legislation Will Significantly Change How Utilities Calculate Residential Electricity Rates

The Legislature is requiring the CPUC to authorize a fixed charge based on income in default residential electricity rates starting no later than July 1, 2024, along with an additional charge that is based on usage. Essentially, the more a household earns, the more it will pay for recurring charges that are not directly affected by energy usage. These fixed charges should generally cover a utility's cost of providing electric grid access to customers, including its ongoing costs related to billing and customer services. They should also cover a utility's other costs that do not directly correlate to customers' usage of electricity, such as expenses related to preventing and mitigating catastrophic wildfires.

The new legislation gives the CPUC broad flexibility in setting the exact amounts of the fixed charges. However, it states that the CPUC must ensure that the charges it authorizes do not unreasonably impair environmental incentives related to issues such as conservation and do not overburden low-income ratepayers. It requires the CPUC to assign the charges according to at least three tiers of income so that low-income ratepayers receive lower average monthly bills without making any changes in their electricity usage.

In response to this legislation, SCE, SDG&E and PG&E have submitted a joint proposal to the CPUC for a new system that they believe will lower utility bills for lower-income customers while also providing transparency regarding how much it costs the utilities to actually deliver electricity to customers. Table 9 illustrates the three major utilities' initial proposal, which includes three primary income tiers and additional discounts for customers at the lowest income levels. The utilities assert that their proposed fixed charges vary by utility because they each have unique revenue requirements, customer distributions, and service options.

The CPUC's proceeding to determine the final fixed charge amounts was ongoing at the time of this audit, and it intends to resolve questions that the utilities and others, including Cal Advocates, have identified. For example, the CPUC will need to determine whether or how a third party, such as a state agency, could verify customers' household incomes. Further, Cal Advocates has issued its own proposal, with generally lower fixed charges for each utility, which it indicates will provide lower-income customers with more cost savings while also allowing customers with solar power systems to significantly reduce their energy bills. Under Cal Advocates' proposal, the per-kilowatt hour rate of electricity would be higher than the rate under

Table 9
The Three Major Electric Utilities Have Proposed Monthly Fixed Charges, Depending on Household Income

	HOUSEHOLD INCOME* LESS THAN $28,000	HOUSEHOLD INCOME* $28,000–$69,000	HOUSEHOLD INCOME* $69,000–$180,000	HOUSEHOLD INCOME* $180,000+
SDG&E	$24	$34	$73	$128
PG&E	$15	$30	$51	$92
SCE	$15	$20	$51	$85

Source: April 7, 2023, joint testimony by SCE, PG&E, and SDG&E describing Income-Graduated Fixed Charge Proposals.

* The utilities proposed income tiers based on eligibility for existing discount programs and federal poverty levels. The income levels we provide here are approximations that SDG&E published for a four-person household based on the 2022 federal poverty guidelines.

the utilities' proposal, but the fixed charges would range from about $10 to $42 per month, depending on annual income and utility.[24] Thus, lower-usage households could see lower bills under the Cal Advocates' proposal than under the utilities' proposal, but higher-usage households could see higher bills that also vary more by month.

The economic impacts of basing electricity bills on income remain unclear. Studies we reviewed have indicated that fixed charges are a way to lessen the effect of utility costs on lower-income households and ensure that bills better reflect the actual costs to manage utility infrastructure and generate and deliver electricity. Some other utilities, such as municipal power companies, already include a monthly fixed charge in electricity bills. However, California would be one of the first states to base these charges on household income. Although this type of reform may reduce bills for certain households, it will likely raise payments for others, including high-income households in energy-efficient homes. Environmental groups have also indicated that this new structure would need to be balanced with incentives for conservation because even the most efficient households would not be able to reduce their bills to less than the fixed charge amount. Thus, the CPUC's eventual decision may significantly affect residential billing and usage in the coming years.

Recent Reforms to the State's Renewable Energy Program Could Lessen Rate Increases for Some Customers

The CPUC, Cal Advocates, and the electric utilities we reviewed have identified the State's renewable net energy metering program (energy program) as a driver of higher electricity rates. The energy program provides customers with an incentive to generate their own power, typically by installing solar panels. The program has historically allowed residential customers with solar power systems to sell the excess energy they generate back to utilities at prices comparable to the typical electricity

[24] Cal Advocates further explained that its proposal would have the fixed charges for the lowest income tier of customers eliminated by a separately funded bill credit of about $10 to $27.

rates that the utilities charge customers. According to a study commissioned by the CPUC, the energy program has caused a group of participants to pay about $620 million less than the cost to serve them annually. Based in part on this study, Cal Advocates, utilities, and an independent advocacy organization estimated that the energy program has essentially shifted billions of dollars in costs from customers with solar power systems to those who do not have such systems. In fact, when accounting for more recent data and additional participant groups, the CPUC has estimated that the total annual cost shift related to one group of participants could be from $1 billion to $3.4 billion.

In December 2022, the CPUC took a significant step intended to mitigate rate increases related to solar adoption. The CPUC's decision phased out its energy program in early 2023 for new participants and created a new solar power incentive program (new program) that includes an approximate $15 fixed fee for solar power customers. It also establishes bill credits for those customers to export energy back to the utility, with the amount of credit tied to the time of day at which the customers generated the electricity. The new program became effective for solar power customers who submitted an application on or after April 15, 2023. According to the CPUC, the new program will compensate solar power residents at an amount that reflects the actual value of the electricity they generate and export, depending on the time of day they export that electricity to the utility.

Although the new program represents a step forward in reducing rate impacts on customers who do not have solar power systems, it may not fully address the cost imbalances created by incentivizing solar power adoption. Cal Advocates believes that the reduced amounts of credits on solar customer bills resulting from the new program will cut costs for some customers without such systems but argued that generally the new program will only slow down—not stop—overall rate increases. For example, Cal Advocates' analysis of the new program's long-term rate impacts suggests that SDG&E customers could eventually save an average of $16 a month from the reform because of slower rate increases but will only receive negligible savings on rates in the short term.

The CPUC Has Begun Reviewing How It Can Better Incentivize Customers to Transition From Using Natural Gas to Electricity

In recent years, the State's long-term goal of reducing residential greenhouse gas emissions has influenced many of the CPUC's policy and ratemaking efforts. In particular, the CPUC has identified a long-term reduction in natural gas use as a broad policy goal that will decrease emissions and safety hazards related to natural gas distribution and burning. Part of the State's recent efforts to transition customers away from natural gas involves making it cost-effective for households to use more electricity instead of gas. The major electric utilities reported that they proposed the fixed monthly charges for electricity to the CPUC in part to encourage residents to adopt electric vehicles and switch from natural gas-powered to electricity-powered appliances. We show the proposed fixed monthly charges in Table 9. Under their proposals, the fixed charges would lower the electricity rates that are based on usage. As a result, customers' increasing their electricity usage to charge a new electric

vehicle or use a new appliance would see relatively smaller electricity bill increases than they would under existing rates, which are based on kilowatt-hour usage, while also saving on monthly gasoline or natural gas costs.

The CPUC, with input from the utilities, Cal Advocates, and other stakeholders, is also moving away from authorizing higher rates for customers using greater amounts of electricity. The CPUC authorizes some electricity rates in tiers, so that high-usage households are charged more per kilowatt-hour. The CPUC indicated that most residential electricity customers in the past have received services through this tiered-rate system. In 2021 the CPUC approved a pilot program at PG&E, SCE, SoCal Gas, and SDG&E to cap customers' bills according to income for a limited number of participants. Under this program, a monthly bill for a participating household no longer increases with additional usage after the bill reaches the income-based cap, thus removing a barrier to the household's using more electricity for a new appliance or electric vehicle. The CPUC explained that it has not yet evaluated the program but that it has directed a consultant to complete an evaluation after 18 months of data are available, after which the CPUC will consider additional utility proposals to modify the program.

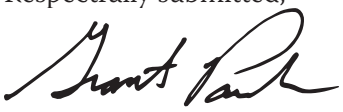
The CPUC has recently issued several other decisions that encourage switching from natural gas and gasoline to electricity by explicitly limiting the bill increases that certain customers would experience when using more electricity. For example, in 2021 the CPUC removed an extra charge for unusually high usage from PG&E's, SCE's, and SDG&E's electricity rates. This decision was an example of the CPUC's efforts to simplify the tiers in rates—an effort that will conclude by July 2024. In another recent rate reform decision, the CPUC in 2022 approved a pilot program for electric vehicle owners and certain other residents in SDG&E's service area through which they can pay a small fixed charge to reduce their volumetric rates as an incentive to charge their vehicles; however, this program was initially capped at 10,000 enrollees.

The CPUC is also engaging in long-term planning on phasing out natural gas infrastructure to move gas-reliant households to electricity, while also evaluating how to keep natural gas rates low for those who use it. The research and the CPUC planning documents we reviewed have indicated that this transition could be a possible long-term solution to limit further increases in electricity rates because increased electricity demand would spread out fixed costs over a larger customer base. The CPUC has been examining how and when to remove aging infrastructure such as gas pipelines and considering how this process might affect usage and rates. For example, SoCal Gas proposed implementing a departing gas customer charge so that customers who keep using natural gas, such as households that cannot afford new electric appliances, do not experience significant price increases as the customer base shrinks overall.

However, neither these reforms nor the electricity rate reforms we previously discuss will necessarily change the costs of delivering energy to customers; rather, the reforms represent policy initiatives intended to reduce natural gas system costs and to reallocate costs among different groups of customers. Thus, it is still important that CPUC and Cal Advocates work to improve their oversight processes to best protect Californians from excessive bills.

We conducted this performance audit in accordance with generally accepted government auditing standards and under the authority vested in the California State Auditor by Government Code section 8543 et seq. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on the audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Respectfully submitted,



GRANT PARKS
California State Auditor

August 29, 2023

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Appendix A

KEY FACTORS RELATED TO SDG&E'S ELECTRICITY RATE INCREASES

As we discuss in the Introduction and in Chapter 1, SDG&E has some of the highest electricity rates in the nation. To identify the factors contributing to SDG&E's electricity rate changes from January 2022 through January 2023, we reviewed its December 2022 consolidated annual advice letter for electricity services as well as the other advice letters it filed during the year that affected its rates. Table A shows an excerpt of SDG&E's revenue requirements as of January 1, 2022, and January 1, 2023; the change—both in dollars and in percent—between the two; and the reasons for the increases. It also describes the 13 cost components that contributed most to the increase in SDG&E's revenue requirement for 2023. Although the utility identified some cost components that reduced the revenue requirement, the net result of the changes was an increase in the revenue requirement.

Table A
SDG&E's Advice Letter Categories with Major Increases in Revenue Requirements from January 2022 Through January 2023

ADVICE LETTER ITEMS THAT INCREASED	REVENUE REQ. 1/1/2022 *(in thousands)*	REVENUE REQ. 1/1/2023 *(in thousands)*	INCREASE IN REVENUE REQ. *(in thousands)*	PERCENT OF TOTAL INCREASES IN REVENUE REQ.	REASON FOR INCREASE
Base Transmission Revenue Requirement	$1,074,297	$1,193,257	$118,960	12%	*Increase in costs of transmission for 2023. These are pass-through costs regulated by the Federal Energy Regulatory Commission.*
Energy Resource Recovery Account (balancing account)	0	106,559	106,559	11%	*Recovery of prior year's higher-than-expected costs of fuel and purchased power because of increasing prices for fuel and energy.*
General Rate Case	1,619,308	1,716,258	96,950	10%	*Increased revenue requirement authorized in the general rate case.*
Local Generating Balancing Account	-91,972	400	92,372	9%	*Expiration of an offset from 2018 and 2019 overcollection related to local generation costs.*
Power Adjustment Balancing Account—Departed Load	-62,288	-7,362	54,925	6%	*A reduction in the amount refunded from the portfolio allocation balancing account (PABA) for departing customers' share of any above-market costs for power.**
Customer Information System Balancing Account	0	49,157	49,157	5%	*Cost recovery for its new Customer Information System.*
Post-1997 Electric Energy Efficiency Balancing Account†	-45,440	0	45,440	5%	*Expiration of a prior-year offset resulting from overcollection that reduced the 2022 revenue requirement.*
California Alternative Rates for Energy Balancing Account†	34,000	79,000	45,000	5%	*Recovery of prior years' undercollection of funds in the California Alternative Rates for Energy (CARE) balancing account.*

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ADVICE LETTER ITEMS THAT INCREASED	REVENUE REQ. 1/1/2022 *(in thousands)*	REVENUE REQ. 1/1/2023 *(in thousands)*	INCREASE IN REVENUE REQ. *(in thousands)*	PERCENT OF TOTAL INCREASES IN REVENUE REQ.	REASON FOR INCREASE
Local Generation Revenue Requirement	146,824	189,849	43,025	4%	*Increased costs of local generation resources that commit to provide additional generating capacity when needed for system reliability—partially because of higher energy costs.*
Power Adjustment Balancing Account	-49,397	-7,304	42,093	4%	*A reduction in the amount refunded from PABA for any above-market costs of power provided to customers who remain with SDG&E.*
CARE Surcharge and Administration†	144,870	186,051	41,181	4%	*Administration cost for CARE and estimated increase in discounts for CARE customers.*
Energy Efficiency†	80,275	117,574	37,299	4%	*Newly authorized costs and adjustments for multiple energy efficiency programs.*
Greenhouse Gas Costs‡	20,337	45,261	24,925	3%	*Higher indirect costs because of an increase in renewable energy certificate sales.*
39 Other Categories That Increased	-130,315	50,688	181,003	18%	
Total Increases In Revenue Requirement			**$978,888**		

Source: Utility advice letters, CPUC advice letter dispositions, CPUC staff, and CPUC decisions.

* PABA is used to record costs and revenues associated with certain generation resources that are eligible for cost recovery through rates.

† These cost components are for public purpose programs, which are state-mandated initiatives such as CARE, which provides eligible low-income customers with a 30 to 35 percent discount on their electric bill, and Energy Efficiency, which refers to various programs with goals of achieving energy savings.

‡ Greenhouse Gas Costs are costs related to greenhouse gas emissions that come from burning fuel to make electricity.

Appendix B

Scope and Methodology

The Joint Legislative Audit Committee (audit committee) directed the California State Auditor (state auditor) to conduct an audit of the processes that SDG&E and other utilities use to determine rate increases for customers and of how the CPUC approves those increases. Specifically, the audit committee requested that we review the CPUC's general rate cases to determine, among other things, whether the proceedings and the CPUC's other efforts adequately protect customers from excessive increases in their utility bills. The audit committee also requested that we review Cal Advocates' processes for ensuring that utilities charge the lowest possible rates for utility services. The table below lists the objectives that the audit committee approved and the methods that we used to address them.

Table B
Audit Objectives and the Methods Used to Address Them

	AUDIT OBJECTIVE	METHOD
1	Review and evaluate the laws, rules, and regulations significant to the audit objectives.	Reviewed and evaluated state laws and regulations applicable to the CPUC's and Cal Advocates' roles in the proceedings that affect rates.
2	Review the CPUC's general rate case proceedings over the last three years for SDG&E and a selection of similar investor-owned utilities to assess the following: a. Whether the proceedings and other efforts by the CPUC adequately protect customers from excessive increases in their utility bills. b. The extent to which major costs, including but not limited to wildfire risk mitigation and natural gas fuel prices, have contributed to rate increases. c. Whether the CPUC considers and utilities report the cost per kilowatt-hour that they charge customers. d. The CPUC's role in overseeing rates the utilities charge outside of the general rate case proceedings.	• Interviewed CPUC staff to understand its role in the general rate case proceedings. • For the most recently approved general rate case proceedings for SDG&E, SoCal Gas, SCE, and PG&E, evaluated the CPUC's practices in overseeing the proceedings. • For the most recently approved general rate case proceedings for the four utilities, reviewed the CPUC's decisions to identify the major cost categories contributing to increases in utilities' operating expenses and revenue requirements. • For the largest cost categories, reviewed available documents from the CPUC and requested additional information from utilities to determine the key factors and reasons contributing to the increases in these categories. • Reviewed the tariffs that utilities post on their websites to identify electric and natural gas rate changes from January 2022 through January 2023 for SDG&E, SCE, SoCal Gas, and PG&E. Performed further analysis as described in Objective 4 to identify the reasons for rate changes. • Reviewed available documentation and interviewed CPUC staff to determine whether utilities report their cost per kilowatt-hour to the CPUC. • Interviewed CPUC staff and reviewed available documentation to determine whether the CPUC appropriately approved rate changes through advice letters between general rate case proceedings.

continued on next page . . .

	AUDIT OBJECTIVE	METHOD
3	Review efforts by Cal Advocates, including its role in reviewing balancing accounts that the CPUC requires public utilities to use to track revenues and expenses associated with authorized rates, to determine the following: a. Whether it is performing its mission to obtain the lowest possible rate for service consistent with reliable and safe service levels. b. Whether it has created and follows a systematic process that ensures a review of all balancing accounts that can have the most impact on customers. c. Whether it has a role—outside of general rate cases—that should be expanded to further advocate for ratepayers.	• Reviewed CPUC rules authorizing utilities to submit general rate case applications that justify changes to their rates and submit advice letters that change their rates based on the revenues and expenses they track in balancing accounts. • Reviewed Cal Advocates' documented policies and training and interviewed staff to determine its process for reviewing general rate case applications and advice letters and issuing protests of each. • Reviewed the most recent general rate case applications for SDG&E, PG&E, SCE, and SoCal Gas to determine whether Cal Advocates protested those applications and the extent to which Cal Advocates' arguments were persuasive to the CPUC. • Interviewed Cal Advocates staff and reviewed available documentation to determine whether Cal Advocates assesses whether its interventions in the general rate case process have resulted in maintaining low rates for ratepayers. • As part of the work described in Objective 7, reviewed whether Cal Advocates implemented recommendations from two of our previous audit reports related to its review of balancing accounts. • Interviewed staff and reviewed available documents to assess Cal Advocates' process for determining how many and which balancing accounts it reviews and to evaluate whether its methods are appropriate for gaining assurance that balancing account information is accurate. • Identified the number of electricity and natural gas balancing accounts Cal Advocates reviewed in the past three years for PG&E, SCE, SDG&E, and SoCal Gas. • For a judgmental selection of nine balancing accounts, assessed whether Cal Advocates followed its review process. • For a selection of advice letters, identified whether Cal Advocates issued protests or otherwise documented its review. • Based on the procedures above and interviews with Cal Advocates staff, determined that Cal Advocates' role in advocating for ratepayers is appropriate.
4	For SDG&E and a selection of similar investor-owned utilities, review any comparatively high utility rates charged to ratepayers since winter 2021 by assessing the following: a. The factors that contributed to these high utility rates. b. Any role or analysis that the CPUC performed in approving or denying rate increases since winter 2021. c. To the extent possible, whether the utilities have financially benefited from high utility rates. d. The costs the utilities requested for rate recovery compared to the amount approved for recovery by the CPUC. e. How rate proposals from the past three years compare between SDG&E and other large electrical corporations.	• Interviewed CPUC and Cal Advocates staff, along with staff from the four utilities, to identify the most significant factors contributing to the electricity and natural gas rate changes from January 2022 through January 2023 identified in Objective 2 and determined the reasons for the increases. • Reviewed advice letters related to the electricity and natural gas rate increases from January 2022 through January 2023 to identify the reasons for the increases. • For a selection of advice letters related to rate increases for the four utilities since winter 2021, reviewed available documentation and interviewed CPUC staff and determined that the CPUC appropriately reviewed the advice letters before approving them. • Interviewed CPUC and Cal Advocates staff to determine the rationale and methodology used to authorize a utility's rate of return and to monitor a utility's actual rate of return and profit. • Obtained from the CPUC and the four utilities financial documents and compared the utilities' authorized rates of return to their actual rates of return. • Investigated reasons that utilities' actual rates of return were higher than the authorized rates of return. • Compared the requested revenue requirement and proposed rates in the latest approved general rate cases for SDG&E and the two other large electrical utilities—PG&E and SCE—to the amounts approved by the CPUC. Reviewed available documents and interviewed staff to identify the reasons for any differences. • Determined that differences in proposed rates stem from factors including the utilities' approved revenue requirements, the composition of the utilities' customer categories, and the costs incurred by the utilities when serving those different customer categories.

continued on next page . . .

	AUDIT OBJECTIVE	METHOD
5	For SDG&E and a selection of similar investor-owned utilities, review applications for recovery of wildfire risk mitigation expenditures to determine the following: a. The amount and use of these funds and how much the utilities received via applications for cost recovery. b. Whether the expenditures were appropriate. c. If possible, the extent to which the expenditures were reimbursed and spent without a return on equity for the utilities.	• Interviewed appropriate CPUC and Cal Advocates staff and reviewed pertinent documentation to determine the methods that utilities use to recover wildfire risk mitigation expenses. • Reviewed cost recovery applications that utilities have submitted since 2019 and the CPUC's related decisions to identify the amounts that the utilities requested and the amounts that the CPUC approved. • Interviewed CPUC and Cal Advocates staff and reviewed available documentation to determine their processes for ensuring the appropriateness of the expenditure amounts that utilities requested. • Reviewed the cost recovery applications and related CPUC decisions to determine capital expenditures subject to a return on equity. Confirmed with CPUC staff the total capital expenditures that were subject to earning a rate of return.
6	Identify best practices that could better protect California utility customers from excessive rate increases.	• Based on our review of documentation and processes related to the other audit objectives, determined whether the CPUC could better protect utility customers from excessive rate increases by employing any identified best practices. • Reviewed available reports online for California, other states, and the federal government to identify any best practices. Determined that the CPUC and Cal Advocates already employ many such practices.
7	Review prior audit reports related to utility ratesetting and rate increases and determine whether the CPUC and utilities have implemented relevant audit recommendations.	• Identified recommendations from the State Auditor's prior audits of the CPUC and Cal Advocates that were relevant to this audit's objectives and to oversight of power utilities. • Interviewed appropriate staff from the CPUC and Cal Advocates to determine the status of their implementation of these recommendations. Based on available documentation and previous responses by the CPUC and Cal Advocates on the status of the recommendations, we found that each were fully implemented, with the exception of one. Specifically, the CPUC has made progress on this recommendation and in March 2023 implemented procedures to address our previous audit findings. We will continue to review the CPUC's progress in implementing this recommendation as part of our office's regular follow-up process. • Identified recommendations from external audits required by the CPUC for utilities and selected three audits for additional testing. • Interviewed appropriate CPUC staff and reviewed CPUC and utility documents to determine the status of the implementation of these recommendations. Determined that the CPUC took appropriate actions to ensure that utilities addressed these recommendations.
8	Review and assess any other issues that are significant to the audit.	• Interviewed CPUC and Cal Advocates staff and reviewed any analyses they had performed to understand the reasons for SDG&E's higher rates compared to other utilities. • Reviewed available data to validate the CPUC's and Cal Advocates' explanation for SDG&E's rate increases. • Reviewed the CPUC's 2022 legislative report on actions to reduce utility costs to identify its key explanations for why electricity and natural gas rates were increasing. • Evaluated the information, evidence, and underlying analysis supporting the CPUC's assessment in its 2022 legislative report.

Source: Audit workpapers.

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STATE OF CALIFORNIA GAVIN NEWSOM, *Governor*

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

August 9, 2023

Grant Parks*
California State Auditor
621 Capitol Mall, Suite 1200
Sacramento, CA 95814

CALIFORNIA PUBLIC UTILITIES COMMISSION RESPONSE TO CSA AUDIT (2022-115) - ELECTRICAL AND NATURAL GAS RATES AUDIT

Dear Grant Parks:

The California Public Utilities Commission (CPUC) provides our response to the draft report findings of the California State Auditor's (CSA) report entitled, *Electrical and Natural Gas Rates: The California Public Utilities Commission Can Better Ensure That Rate Increases Are Necessary.*

The CPUC is committed to the continuous improvement of its operations. Accordingly, the CPUC will establish a corrective action plan and timelines toward implementing the recommendations identified in this report as set out in our response below.

As Executive Director of the CPUC, I am deeply proud of our staff's analytical work supporting the Commission's decision-making about rates that Californians pay for essential services like electricity and gas, as evidenced in CSA's report. Our commitment to service and accountability to Californians drives us every day.

The CPUC appreciates the work performed by the CSA and the opportunity to provide our response to the findings. If you have further questions, please contact me at (415) 757-7844 or Staff Attorney Matt Yergovich at (415) 596-3474.

Sincerely,
Rachel Peterson
Rachel Peterson
Executive Director

Enclosure

cc: Alice Reynolds, President
California Public Utilities Commission

Christine Hammond, General Counsel
Legal Division

Angie Williams, Director
Utility Audits, Risk and Compliance Division

* California State Auditor's comments appear on page 77.

CALIFORNIA PUBLIC UTILITIES COMMISSION RESPONSE TO CSA AUDIT (2022-115) - ELECTRICAL AND NATURAL GAS RATES AUDIT

> **Recommendation 1:** To promote transparency, the CPUC should by February 2024 institute a process to require utilities to periodically publish actual rate-of-return calculations using a methodology acceptable to the CPUC and Cal Advocates. Further, when the actual rate of return significantly exceeds the authorized rate of return, the CPUC should require the utilities to identify the major costs categories where projected costs exceeded actual costs and provide supporting documents. The CPUC's Energy Division should then publish this information so that it is available to Cal Advocates and other interested parties, and it should objectively analyze the information for the CPUC.

CPUC Response: ☒ Agrees ☐ Disagrees with the recommendation or partially agrees.

The CPUC agrees with and will implement this recommendation.

The Commission already publishes the utilities' actual rates of return. To add transparency to the rate of return calculations, the CPUC will develop an additional process to require utilities to periodically publish actual rate-of-return calculations using a methodology acceptable to the CPUC and Cal Advocates.

The CPUC already regularly requires utilities to report over- or under-spending where projected costs exceeded actual costs, or vice versa. The utility over- and under-spend is regularly presented by parties to CPUC proceedings. Notwithstanding these requirements, the CPUC will implement a process to identify when a utility's overall actual rate of return significantly exceeds the authorized rate of return, so that an Administrative Law Judge (ALJ) may additionally require the utilities to identify the major cost categories where projected costs exceeded actual costs and provide supporting documents.

Energy Division advisory staff will continue to objectively analyze relevant cost category information provided within a proceeding, and to advise ALJs and decisionmakers.

Recommendation 2: To ensure the appropriateness of the activities that utilities include in their cost recovery applications and to reduce the risk of utilities' attempting recovery of costs for work they did not complete, the CPUC should develop a process to do the following by the beginning of February 2024:

> **Recommendation 2A:** Ensure that it reviews available reports and work completed by other divisions within the CPUC and other state agencies to determine whether further verification of a utility's work is necessary.

CPUC Response: ☐ Agrees ☒ Disagrees with the recommendation or partially agrees.

The CPUC partially agrees with and will partially implement this recommendation.

① Considering the CPUC's quasi-judicial structure, this recommendation cannot be implemented to the extent it requires CPUC staff or an ALJ to unilaterally review such outside reports and determine whether further verification of a utility's work is necessary.

Instead, the CPUC will ensure internal awareness is raised about reports that might be relevant to help verify a utility's actual work completion, so that an assigned ALJ may assess whether to include reference to such reports in the proceeding scope.

Parties to the proceedings will then make their own litigation determinations, including whether to file motions to include the reports in the record of the proceeding, and use the contents of the reports in the course of their litigation. This will allow parties to bring forward the relevant elements of such reports as part of building the record that supports decision-making.

> **Recommendation 2B:** Include an audit procedure that requires, on a sample basis, verification that work was completed as claimed in the utility's cost recovery application. For example, perform site visits, obtain photographic evidence of work completed, or use satellite imagery.

CPUC Response: ☒ Agrees ☐ Disagrees with the recommendation or partially agrees.

The CPUC agrees with and will implement this recommendation.

When conducting its audits, the CPUC's Utility Audits Branch (UAB) will continue to include an audit procedure that requires verification of work on a sample basis and when appropriate. In addition, the CPUC will consider other inspection activities being carried out by the utilities and other state agencies to avoid waste, avoid duplication of effort, and ensure value for ratepayers. (2)

Recommendation 3: To ensure that customers can readily identify the factors that contribute to energy rate increases when rates change, the CPUC should do the following beginning in February 2024:

> **Recommendation 3A:** Provide to the public a summary of energy rate increases. Although the CPUC should determine the exact approach for communicating these increases, this approach – at a minimum – should identify the previous rate, the new rate, and the expected impact of the average customer's bill, and should also explain the CPUC-approved cost components that are driving the rate increase.

CPUC Response: ☐ Agrees ☒ Disagrees with the recommendation or partially agrees.

The CPUC partially agrees with and will partially implement this recommendation.

The CPUC acknowledges the significance of transparent and comprehensive public communication. Utilities have the most accurate customer contact information and maintain consistent and frequent communication, and so they are best positioned to engage with their customers directly. Therefore, the CPUC appropriately mandates utilities to communicate directly with their customers. Customers anticipate communication from essential service providers, especially during emergencies. For instance, when global market conditions increased the cost of wholesale natural gas in 2022, the CPUC prompted utilities to inform customers about conserving gas. The CPUC has also issued prompts and directives to utilities to engage with their customers during wildfire season. During non-emergency rate-altering events, the CPUC directs utilities to engage with their customers through bill inserts, websites, and emails. (3)

④ To expand on these efforts and address rate changes arising from general rate cases (GRCs) directly, the CPUC will craft a communication strategy. This will direct utilities to establish suitable pathways and frequencies for communicating rate increases arising from GRCs and other cost-related applications, implemented through advice letters.

Recommendation 3B: Post all summaries on its webpage in a timely fashion. It should also require utilities to reference these summaries on their websites within a reasonable time frame.

CPUC Response: ☒ Agrees ☐ Disagrees with the recommendation or partially agrees.

The CPUC agrees with and will implement this recommendation.

④ Similar to the CPUC's response to Recommendation 3A, the CPUC will incorporate this recommendation into the communications strategy.

Comments

CALIFORNIA STATE AUDITOR'S COMMENTS ON THE RESPONSE FROM THE CALIFORNIA PUBLIC UTILITIES COMMISSION

To provide clarity and perspective, we are commenting on the CPUC's response to our audit. The numbers below correspond to the numbers we have placed in the margin of the response.

We are perplexed by CPUC's response. The CPUC states that it cannot implement this recommendation to the extent it requires the CPUC staff or an administrative judge to unilaterally review outside reports and determine whether further verification is necessary. However, as we state on page 40, the CPUC has broad authority to develop rules that govern how utilities apply for cost recovery and to compel utilities to provide any information necessary to justify those costs. Further, as we explain on page 41, different divisions within the CPUC and other state agencies publish reports that may demonstrate whether a utility has completed the work for which it is requesting to recover costs. Thus, we stand by our recommendation. ①

The CPUC explained that it currently includes an audit procedure to require verification of work on a sample basis. However, we note that this is a very recent practice. As we explain on page 43, the CPUC completed an audit of SCE's cost recovery application for wildfire mitigation activities in June 2023. Although this particular audit included verification that selected activities occurred, this was the only audit of a cost recovery application that it has published. To fully implement our recommendation, we expect this to be an audit procedure that is instituted on an ongoing basis. ②

The CPUC mischaracterizes our recommendation. Our recommendation does not suggest that the CPUC should communicate directly with utility customers—a role it states is best left to utility companies. Our recommendation specifically states that the CPUC should determine the exact approach for communicating energy rate increases to utility customers, leaving open the possibility of any number of communication methods, including a simple posting on CPUC's website. ③

We are puzzled by the CPUC's response given its statutory responsibility. Specifically, as we explain on page 43, the CPUC is the public agency responsible for regulating utilities to ensure that customers have safe, reliable utility services at reasonable rates. Thus, it is critical that the CPUC establish and implement a communication strategy that clearly explains to customers why their rates are increasing. Doing so will demonstrate to the public that the CPUC is carrying out its responsibility for ensuring reasonable utility rates. ④

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The Public ADVOCATES OFFICE

August 10, 2023

Grant Parks*
California State Auditor
621 Capitol Mall, Suite 1200
Sacramento, CA 95814

Subject: Public Advocates Office Response to August 2023 Draft Audit Report

Dear State Auditor Parks,

The Public Advocates Office at the California Public Utilities Commission (Cal Advocates) acknowledges receipt of the California State Auditor's redacted draft report, Report 2022-115.

Cal Advocates appreciates the State Auditor staff's effort to execute the direction provided by the Joint Legislative Audit Committee in 2022 to review how San Diego Gas & Electric Company and other utilities determine rate increases for ratepayers. The State Auditor's staff also was tasked with reviewing how the California Public Utilities Commission (CPUC or Commission) approves those increases as well as Cal Advocates' role in the ratemaking process.[1]

Cal Advocates agrees with the Draft Report that the rates of the largest energy utilities[2] have increased significantly in recent years. In fact, Cal Advocates has publicly raised this very issue along with recommendations to create downward pressure on rates. In addition to threatening the affordability of essential energy services, increasing electricity rates will hamper California's transition to beneficial electrification as a means to combat climate change and other environmental challenges.

With this focus in mind, Cal Advocates provides the following responses to the recommendations identified in the Draft Report. (1)

[1] Letter from Acting State Auditor, Michael S. Tilden, dated July 15, 2022.

[2] The large energy utilities are Pacific Gas and Electric Company (PG&E), Southern California Edison Company (SCE), San Diego Gas & Electric Company (SDG&E), and Southern California Gas Company (SoCalGas).

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* California State Auditor's comments appear on page 83.

Cal Advocates' Responses to Recommendations

1. **To help ensure that the utilities' projected costs are not overstated, Cal Advocates should first obtain information the CPUC requires utilities to provide, including their actual rate-of-return calculations and major cost categories where utilities achieved significant cost savings. It should use this information in subsequent rate case proceedings to assess the risk that projections in these cost categories may be overstated and it should scrutinize the projections accordingly.**

   The primary focus of Cal Advocates' reviews of the utilities' forecasted costs is to evaluate such costs for reasonableness and accuracy, including whether the utilities have justified their costs and whether such costs are overstated. Obtaining information from the utilities about their actual rates-of-return calculations and major cost categories where they have achieved significant cost savings could help to advance our efforts to evaluate utility forecasted costs. The energy utilities file Risk Spending Accountability Reports (RSARs) at the CPUC. In April 2023, California's large investor-owned utilities began providing improved detailed reports to the CPUC pursuant to CPUC decision D.22-10-002. These reports provide the basis for the Energy Division's analysis of utility spending authorized in the CPUC's GRC decisions. The energy utilities are required to report any variance between authorized and actual spending, as well as completion status, for programs related to safety, reliability, and maintenance. The RSARs and the Energy Division's analyses of the RSARs could assist Cal Advocates' efforts to evaluate the utilities' forecasted costs.

   As discussed in the Draft Report, in September 2022, Cal Advocates formally proposed that the CPUC adopt an earnings test that would compare a Class A water utility's authorized return on equity to its actual return on equity.[3] Cal Advocates developed its proposed earnings test exclusively to address Class A water utilities. The CPUC has not yet ruled on Cal Advocates' proposed earnings test for the Class A water utilities. This is important to note because the use of any earnings test as a meaningful evaluation tool first must be recognized by the CPUC. ②

2. **To help ensure the appropriateness of the activities that utilities include in their cost recovery applications and reduce the risk of utilities' attempting to recovery [sic] of costs for work they did not complete, Cal Advocates should develop a process by February 2024 to gain additional assurance that utilities actually performed the work claimed. This process should include the following steps:**

[3] *Motion of the Public Advocates Office to Timely Address Water Affordability Policies in Phase III of Rulemaking 17-06-024* filed at the CPUC on September 30, 2022.

- **Evaluating available reports and work completed by other CPUC divisions and other agencies to determine whether further verification of a utility's work is necessary.**
- **If it determines that further verification is necessary, obtaining additional information from utilities to verify completion of the work. Leverage the audit work that the CPUC performs to avoid duplication of effort.**

Cal Advocates recognizes that there is merit in gaining assurance that a utility has performed and/or completed the work for which it seeks to recover costs through the evaluation of available reports provided by the CPUC and other agencies to the extent such reports are relevant and timely. If necessary, additional information provided by the utilities could be used to verify completed work, to the extent that the utility cooperates in timely providing the information and/or the CPUC compels the timely production of such information.

3. **To help ensure that utilities can support the rate changes they request, Cal Advocates should do the following:**

    - **Verify whether balancing accounts balances and the resulting rate changes are accurate and compliant with the CPUC rules. Specifically, Cal Advocates should, by February 2024, develop a review plan that outlines a risk-based approach for selecting a specific number of electricity and natural gas balancing accounts to review. This plan should specify the criteria Cal Advocates will use to select the balancing accounts that will have the most impact on rates. If it determines through a staffing analysis that it needs additional staff to perform all the review it plans, it should request additional staff through its annual budget process.**
    - **Consult with the CPUC when developing its review plan to ensure that it is not reviewing the same balancing accounts and that it is most effectively using its resources to identify and review higher-risk accounts.**

The Draft Report assumes that Cal Advocates does not undertake a risk-based approach for selecting balancing accounts to review. In fact, when a utility presents balancing accounts for cost recovery or proposes to establish new balancing accounts in formal applications filed at the CPUC, Cal Advocates evaluates the proposals to, among other things, determine which accounts would have the greatest impact on ratepayers or would not be reasonable to establish. As such, Cal Advocates' reviews of balancing accounts are not intended to cover the majority of existing balancing accounts because most accounts are not presented for review in a formal utility application in which the utility is seeking cost recovery. ③

Furthermore, in many instances large amounts of costs are recorded in a few accounts. Therefore, it is reasonable for Cal Advocates to prioritize its in-depth reviews on those ④

accounts. For example, Cal Advocates conducts annual financial examinations on the Purchased Gas Accounts and related gas procurement accounts for PG&E, SoCalGas, and SDG&E. The costs recorded in these accounts typically amount to 35 – 50% of annual residential gas rates. Moreover, the balance of customers' annual gas bills is primarily composed of revenues authorized through the utilities' general rate cases, and other proceedings. These pre-determined, authorized costs are tracked in fixed cost balancing accounts, which guarantee that the utility can recover these authorized costs. Any undercollections or overcollections in the accounts are primarily attributable to sales fluctuations. These fixed cost balancing accounts are typically reviewed by the CPUC.

③ While Cal Advocates already applies a risk-based approach to selecting accounts for review, there is merit in documenting the approach through the development of a review plan and coordinating with the CPUC on the plan to avoid duplication of work.

4. **To ensure that it consistently and appropriately executes its protests of general rate case applications and advice letters, Cal Advocates should develop written policies and procedures by February 2024 that provide staff with direction on the following:**
    - **The steps taken when reviewing and filing protests on general rate case applications.**
    - **The steps to take when documenting their analyses of incoming advice letters. Each analysis should include the rationale for protesting or not protesting a letter.**

There is merit in establishing written policies and procedures for the review and preparation of written protests to general rate case applications and advice letters to help ensure that staff are
⑤ provided consistent information. Cal Advocates has already begun to develop these written policies and procedures. Cal Advocates also appreciates that while it does document staff's analyses and recommendations regarding advice letters, the process and documentation could be improved to ensure that that information is recorded and maintained.

I thank the State Auditor and its staff for working with Cal Advocates to prepare the Draft Report and for accepting this response. I look forward to ongoing discussions of the issues raised in the Draft Report. Please do not hesitate to contact me if you have any questions about this response at matt.baker@cpuc.ca.gov.

Sincerely,

Matt Baker
Director, Public Advocates Office

Comments

CALIFORNIA STATE AUDITOR'S COMMENTS ON THE RESPONSE FROM THE PUBLIC ADVOCATES OFFICE

To provide clarity and perspective, we are commenting on Cal Advocates' response to our audit. The numbers below correspond to the numbers we have placed in the margin of the response.

Cal Advocates does not always clearly state in its response whether it intends to fully implement our recommendations. We look forward to evaluating its more detailed actions to implement our recommendations as part of our regular follow-up process. (1)

Cal Advocates mischaracterizes our recommendation. Although we state on page 38 that conducting an earnings test can help ensure that the utilities' projected costs are not overstated, we do not recommend that Cal Advocates specifically perform such a test. Rather, we recommend that Cal Advocates use the information that the CPUC requires utilities to provide to assess the risk that projected costs may be overstated. (2)

Although Cal Advocates states that it has a risk-based approach for selecting balancing accounts to review, it did not provide us with documentation to demonstrate it employed such an approach. In fact, as we state on page 53, Cal Advocates explained that it bases its decision to review accounts on whether the electric utilities chose or were directed by the CPUC to include them in annual proceedings. Further, as we state on page 53, although inclusion in a formal proceeding may be a relevant factor for identifying accounts that could affect customers, we are concerned that using this as the only factor is to some extent allowing utilities to dictate which accounts Cal Advocates will review. Therefore, we stand by our recommendation. (3)

Cal Advocates incorrectly implies that it prioritizes reviews of balancing accounts with large amounts. As we show in Table 7 on page 53, Cal Advocates did not consistently review balancing accounts for all utilities. For example, as we state on page 54 and show in Table 7, it reviewed only three of a total of approximately 120 balancing accounts for the largest natural gas utilities. As we state on page 54, these three accounts had total balances of about $20 million as of December 2021, which was less than 1 percent of the cumulative $2.3 billion in total balances across all natural gas-related balancing accounts for the three largest utilities. (4)

Cal Advocates did not make us aware during the audit that it has begun to develop written policies and procedures for the review and preparation of written protests to general rate case applications and advice letters. We look forward to evaluating these policies and procedures as part of our regular follow-up process. (5)